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TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

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YOUR OPPORTUNITY TO COMMENT

Inland Revenue regularly produces a number of statements and rulings aimed at explaining how taxation law affects taxpayers and their agents. Because we are keen to produce items that accurately and fairly reflect taxation legislation and are useful in practical situations, your input into the process, as a user of that legislation, is highly valued.

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

Email your submissions to us at **public.consultation@ird.govt.nz** or post them to:

Public Consultation
Office of the Chief Tax Counsel
Inland Revenue
PO Box 2198
Wellington 6140

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

Ref	Draft type	Title	Comment deadline
ED0200	Standard practice statement	Relief from tax debt	18 May 2018
ED0205	General determination	Tax depreciation rate for skin therapy machines	18 May 2018
ED0206	Standard practice statement	Effective date of GST registrations	31 May 2018

IN SUMMARY

IN SUMMARY (continued)

NEW LEGISLATION

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

ORDER IN COUNCIL

Participating jurisdictions for the CRS applied standard

Determination

New Zealand's list of participating jurisdictions made by determination for the purposes of the CRS applied standard (CRS) and requirements under Part 11B of the Tax Administration Act 1994 on the 21st of June 2017 will be amended with effect from the 1st of April 2018 as follows:

Jurisdictions to be removed from the initial list of participating jurisdictions

Antigua and Barbuda	Aruba	Bahrain	Barbados
Brunei Darussalam	Chile	Cook Islands	Ghana
Israel	Kuwait	Lebanon	Macao (China)
Malaysia	Marshall Islands	Monaco	Nauru
Niue	Panama	Qatar	Saint Kitts and Nevis
Saint Lucia	Saudi Arabia	Sint Maarten	United Arab Emirates
Vanuatu			

Jurisdictions to be added to the initial list of participating jurisdictions

Belgium	Czech Republic	Greenland	Hungary
Indonesia	Liechtenstein	Romania	Slovak Republic

Full list of participating jurisdictions from 1 April 2018

Anguilla	Argentina	Australia	Austria
Belgium	Belize	Bermuda	Brazil
British Virgin Islands	Bulgaria	Canada	Cayman Islands
China	Colombia	Costa Rica	Croatia
Curaçao	Cyprus	Czech Republic	Denmark
Estonia	Faroe Islands	Finland	France
Germany	Gibraltar	Greece	Greenland
Grenada	Guernsey	Hong Kong (China)	Hungary
Iceland	India	Indonesia	Ireland
Isle of Man	Italy	Japan	Jersey
Korea	Latvia	Liechtenstein	Lithuania
Luxembourg	Malta	Mauritius	Mexico
Montserrat	Netherlands	New Zealand	Norway
Poland	Portugal	Romania	Russian Federation
Saint Vincent and the Grenadines	Samoa	San Marino	Seychelles
Singapore	Slovak Republic	Slovenia	South Africa
Spain	Sweden	Turks and Caicos Islands	United Kingdom
Uruguay			

For more information please refer to the Inland Revenue website: **www.ird.govt.nz** (search keyword: participating).

Dated at Wellington on the 28th March 2018

John Nash
Manager, International Revenue Strategy
Inland Revenue

REVENUE ALERT

RA 18/01: Dividend stripping – some share sales where proceeds are at a high risk of being treated as a dividend for income tax purposes

A Revenue Alert is issued by the Commissioner of Inland Revenue, and provides information about a significant and/or emerging tax planning issue that is of concern to Inland Revenue. At the time an alert is issued risk assessments will already be underway to determine the level of risk and to consider appropriate responses.

A Revenue Alert will identify:

- the issue (which may be a scheme, arrangement, or particular transaction) which the Commissioner believes may be contrary to the law or is inconsistent with policy;
- the common features of the issue;
- our current view; and
- our current approach.

An alert should not be interpreted as being Inland Revenue's final position. Rather, an alert outlines the Commissioner's current view on how the law should be applied. For any alert we issue it is likely that some investigatory work has already been carried out.

If people have entered into an arrangement similar to the one described or are thinking about it, they should talk to their tax advisor and/or to Inland Revenue for advice about tax implications.

Many people sell shares in companies each year and pay no tax on the proceeds, either because they do not exceed their cost, or because any gain is on capital account. However, increasingly Inland Revenue is seeing sales of shares to related entities in situations where Inland Revenue considers the sale proceeds are a dividend under the general tax avoidance rule in section BG 1 and also sometimes the dividend stripping rule in section GB 1.

In essence, a dividend is a transfer of value by a company to a shareholder or related person and the transfer is caused by that shareholding. Dividend stripping refers to the sale of shares where some or all of the amount received is in substitution for a dividend likely to have been derived by the seller but for the sale of the shares. The related party scenarios described in this Alert are a subset of arrangements of various kinds known generically as "dividend stripping", but Inland Revenue wants shareholders to be more aware of these situations, and of the department's concerns.

Background

When a person sells shares in a company (the *target*) to an unrelated purchaser, it is generally appropriate for the transaction to be taxed as a sale of the shares rather than a dividend (though this is not always the case, for example if the target company is cashed up, and the sale is for the purpose of avoiding tax on a liquidating distribution). The sale may be on revenue or capital account.

However, if the sale is to a related entity, such as a company in which the seller or sellers have a significant shareholding, the economic effect of the transaction may be that the seller indirectly continues to substantially own the target company. The greater the similarity between the seller's pre and post-sale ownership of the target company, the greater the risk that the transaction should be treated as a tax avoidance transaction. This risk exists regardless of whether or not the target company has liquid assets or retained earnings at the time of sale. For example, the target company may have appreciated assets, or goodwill that has emerged over time.

A recent example of this kind of dividend stripping transaction is *Beacham v CIR* (2014) 26 NZTC 21-111. In *Beacham*, the shareholders in Beacham Holdings Ltd were a husband and wife (the Beachams). They had borrowed approximately $1.1M from the company over a period of years. The borrowing was problematic in that if interest was not charged on it, it would give rise to a taxable dividend to the shareholders. Beacham Holdings had retained earnings of approximately $1.8M. The shareholders sold Beacham Holdings to Beacham Group Ltd, which they also wholly owned, in exchange for a debt obligation of $1.84M. The debt obligation was partly satisfied by various journal entries that operated to set off the shareholders' obligations to repay the amounts borrowed from Beacham Holdings against the obligations owed to them by Beacham Group for the purchase of the Beacham Holdings shares. The remainder of the purchase price was left as a debt outstanding to the Beachams.

The shareholders treated the transaction for tax purposes as a sale of the shares in Beacham Holdings to Beacham Group. However, the court held that it was a dividend stripping transaction, and the shareholders were taxable on the sale proceeds as if they were a dividend. The court did not distinguish between the amounts used to pay the shareholders' overdrawn current account and the amounts left owing to the shareholders.

Inland Revenue has been considering some practices and in some cases investigating sales of shares to related companies. It has come to the view that sometimes the transactions are likely subject to the anti-avoidance rules. This requires consideration of the objective purposes of the arrangements and the test of parliamentary contemplation, as set out in the leading court case in this area.

Current view on dividend stripping in restructuring transactions

The Commissioner's view is that where a person or persons sell shares in a company (the target) to another company (the acquirer) in which the person or persons also has (or have) a significant ownership interest, section BG 1 or section GB 1 can apply in a wider range of circumstances than those in the *Beacham* case. For example, a sale can be subject to section BG 1 where the target has no retained earnings at the time of sale, and where the purchase price is simply left owing to the vendors.

A tax avoidance arrangement may also arise where a holding company structure is used to facilitate the exit of a shareholder, or the merger of two companies.

The Commissioner would also have tax avoidance concerns where an arrangement inappropriately creates available subscribed capital (ASC) for a company in situations where a shareholder in reality has not provided anything for the issue of shares by the company.

Examples

The following examples highlight the Commissioner's concerns. They are not intended to be a comprehensive guide to when sales of shares, either to related or unrelated parties, give rise to a dividend stripping concern.

Example 1: sale of company with no retained earnings, no real ownership change

Target Ltd was 100% owned by a discretionary family trust. It owned and operated a successful medium sized business. Most of the directors were also beneficiaries of the family trust. Target distributed most of its retained earnings as fully imputed dividends each year.

Over a four year period, these dividends averaged $500,000 per annum. Although fully imputed, some of these dividends were subject to additional tax, as the income of the trustee, top marginal rate beneficiaries, or minor beneficiaries subject to the minor beneficiary rule. Others gave rise to tax refunds or reductions, as they were beneficiary income of lower marginal rate beneficiaries.

The family trust sold Target to HoldCo Ltd, for $3.5M, which was $3M above the net equity. The price was supported by a valuation from a registered valuer. The family trust lent HoldCo $3.5M in exchange for a debt obligation. Before the sale, HoldCo was a shell company owned 100% by the family trust. The gain arose from the fact that Target's business was well established, and was generating significant annual profits. There was also a small element of asset appreciation.

After the sale, Target's business continued as before. However, rather than distributing its earnings as dividends over the next three years, it loaned an equivalent amount to HoldCo. HoldCo used the money to repay the debt owed to the family trust. The loan repayments were either retained by the trust or used to make distributions to beneficiaries. They were not returned as taxable income.

The Commissioner asked the trustees of the family trust and their advisors why the shares in Target had been sold. They responded that, consideration was being given to the possibility of going into a new line of business, and that for this purpose it was desirable to have a holding company structure. The new business was going to be operated by a new company, which would be owned by the holding company. No new business had in fact eventuated.

Commissioner's view on Example 1

Looked at objectively, the transaction resulted in no material change in the family trust's commercial position. The family trust continued to own the same business as before, albeit now indirectly through its ownership of HoldCo. The sale proceeds (the $3.5m debt owed to the family trust) are a transfer of value to the family trust for which the trust has not really given up anything from the restructure and the sale of its shares in Target. The loan also means that future loan repayments are not dividends.

It seems unlikely to the Commissioner that Parliament would have contemplated that outcome within the rules in the legislation and therefore the transaction is probably a tax avoidance arrangement. It may also likely be subject to section GB 1 so that the proceeds received by the family trust (the $3.5M debt it is owed) from the sale are treated as being a dividend. This is despite the fact that Target had no retained earnings at the time of the sale, and that there is no immediate transfer of cash to Target at the time of the sale to HoldCo.

The Commissioner's view would be the same if HoldCo were an established company with its own business.

Example 2: sale to holding company: target company assets used to fund shareholder exit

OpCo Ltd was a successful trading company owned 50:50 by two discretionary family trusts, Trust A and Trust B. OpCo had two executive directors, Mr A and Mr B, both of whom worked in and were the founders of the company, and each of whom was the settlor of one of the trusts. OpCo had grown significantly, funded mostly by fully taxed retained earnings, totalling $8M at the time of the transaction. OpCo had very little available ASC, having been funded mostly by shareholder loans which had been repaid. OpCo had only occasionally paid dividends.

Mr B wished to exit the business, and Mr A was keen for his trust (Trust A) to acquire Trust B's shares. The parties agreed on a valuation of $10m for the business.

The sale was structured as follows. All transactions occurred on the same day.

- Trust A set up a new holding company (HoldCo Ltd), with nominal share capital;
- HoldCo acquired all of Trust B's OpCo shares for $5M, issuing an IOU in exchange;
- HoldCo acquired all of Trust A's OpCo shares on the same basis;
- HoldCo borrowed $5M from OpCo's existing bank, secured over OpCo's assets. The provision of security by OpCo was properly dealt with in terms of Companies Act 1993 compliance.
- HoldCo paid the $5M to Trust B in satisfaction of the IOU.

The result of the transaction was that:

- Trust B received $5M cash and gave up its OpCo shares;
- The OpCo /HoldCo group (which was economically identical to OpCo, since HoldCo's only asset was its shares in OpCo) had provided that $5M cash, by HoldCo borrowing from the bank and then providing it to Trust B as the purchase price for Trust B's shares in OpCo.
- Trust A had 100% of a group worth 50% of what it was previously worth, and was owed $5M by the group.

Commissioner's view on Example 2

The Commissioner considers it probable that the transaction is a tax avoidance arrangement. The results seem again to be beyond what Parliament would have contemplated arising.

Firstly, as a result of the transaction, Trust A is owed $5M and now holds its original OpCo shares indirectly, while the OpCo/HoldCo group is able to make payments to Trust A of up to $5M free of tax (by way of debt repayment).

It is also relevant that Trust A has acquired economic ownership of $5m worth of OpCo shares from Trust B, without suffering any economic consequences as it effectively used OpCo's assets. The payment of the purchase price to Trust B has been funded by way of a borrowing by the OpCo/HoldCo group, for which that group is liable, rather than by a borrowing by Trust A, yet the transaction has not been taxed as a distribution;

The tax advantage of the transaction can be counteracted by treating Trust A as receiving a dividend at the time of the transaction.

Example 3: merger using a holding company

A Ltd and B Ltd were medium size trading companies. A Ltd was owned 100% by Mr A, and B Ltd was owned 25% by Mr A and 75% by Mr B. Both companies had very little ASC, having been funded mostly by previous shareholder loans (now repaid). Mr A and Mr B were relatives, and on good personal and business terms. They decided it would be a good idea to merge their companies, which were each valued at $5M, though their tangible assets were valued at only $2M each.

The merger was achieved by forming a new HoldCo owned 62.5% by Mr A and 37.5% by Mr B. Mr A and Mr B provided only nominal amounts for the HoldCo shares and so HoldCo had very little ASC. HoldCo acquired the shares in A Ltd and B Ltd, with $10M of finance provided by the vendors.

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Before the merger, Mr A and Mr B would have been taxable on any amounts distributed to them by their companies, subject to the possibility of returning the relatively small amount of ASC by way of a share repurchase. Leaving aside sections BG 1 and GB 1, immediately after the merger, they would have been able to be paid $10M by HoldCo as a repayment of the purchase price debt.

Within a few months of the sale:

- $5M of the loans were converted into fully paid shares in HoldCo;
- HoldCo, A Ltd and B Ltd were amalgamated in a short form amalgamation, with HoldCo as the continuing company.

These steps were already contemplated at the time that the sale of the shares to HoldCo took place. Accordingly, the ASC of the HoldCo shares issued on conversion of the debt was not the $5M debt discharged by issue of those shares. It was limited by section CD 43(9) and section CD 43(10) to half the ASC of the A Ltd and B Ltd shares on issue before the sale of the A Ltd and B Ltd to HoldCo. Section CD 43(9) and section CD 43(10) limit the ASC of shares issued by a company (in this case HoldCo) where the company receives consideration for those shares, directly or indirectly, in the form of shares in another company (in this case A Ltd and B Ltd), and immediately after the issue, there are 1 or more persons (in this case Mr A and Mr B) whose common voting interests in the company and the other company total 10% or greater.

Commissioner's view on Example 3

Again applying the Parliamentary contemplation test, the Commissioner's view is that these transactions are likely to be a tax avoidance arrangement. Although there is a commercial purpose (the merger of the two businesses), given the facts and circumstances, that purpose has been achieved in a way that means the transaction has a more than merely incidental purpose of tax avoidance. Relevant facts and circumstances include in particular the fact that the ownership of HoldCo reflects the ownership of the two existing companies.

The transaction is likely to be a tax avoidance arrangement subject to section BG 1. The transactions give rise to a dividend of $5M. The Commissioner considers that sections CD 43(9) and CD 43(10) limit the ASC so that the $5M of loan converted to shares does not give rise to any ASC. Even if these sections don't apply to limit the ASC, section BG 1 if applied would affect the ASC created from the arrangement. This is because the effect of the arrangement is that the shareholders have not contributed anything in commercial reality in exchange for the shares issued to them upon conversion.

Current status

Inland Revenue has been considering arrangements of the type outlined above and has commenced investigations into a number of taxpayers who have entered into restructuring arrangements like those described.

Where Inland Revenue considers that sale proceeds, debt repayments or other value transferred are in substance a dividend, the Commissioner will assess the shareholder on the amount of the dividend. The Commissioner may also assess the company for resident or non-resident withholding tax, except where the dividend arises as a result of a reconstruction under section GB 1(3) (see sections RE 2(5)(j) and RF 3(2)).

Late payment penalties and use of money interest may be applied to taxpayers entering into the types of arrangement described in this Revenue Alert.

Shortfall penalties may also apply, although these may be reduced where a voluntary disclosure is made.

If you consider that our concerns may apply to your situation, we recommend you discuss the matter with your tax advisor or with us, and consider making a voluntary disclosure.

Guidelines for making a voluntary disclosure are contained in our booklet *Putting your tax returns right (IR280)* (**www.ird.govt.nz/forms-guides/number/forms-200-299/ir280-guide-putting-your-tax-returns-right.html**) and *Standard Practice Statement 09/02 Voluntary disclosures (May 2009)* (**www.ird.govt.nz/technical-tax/standard-practice/shortfall/sps-09-02-voluntarydisclosures.html**).

Legislative references:	Sections BG 1, CD 43, GA 1, GB 1, RE 2(5)(j) and RF 3(2)) of the ITA 2007;
Case Law	*Beacham v CIR* (2014) 26 NZTC 21-111
Statement on tax avoidance:	IS 13/01 - Tax Avoidance and the interpretation of sections BG 1 and GA 1 of the Income Tax Act 2007
Date issued:	13 March 2018
Authorised by	Graham Tubb
Contact (via email):	**revenue-alerts@ird.govt.nz**
Media queries:	04 890 1674 **mediaqueries@ird.govt.nz**

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 18/01: Livestock Improvement Corporation Limited

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 Livestock Improvement Corporation Limited,
IRD No: 49-836-279.

Taxation Laws

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

This Ruling applies in respect of ss BG 1, CB 1, CB 3, CB 4, CB 5, subpart CD and the definition of "non-taxable bonus issue" in s YA 1.

The Arrangement to which this Ruling applies

The Arrangement is a series of steps detailed below resulting in the reclassification of two classes of shares (Co-operative Control Shares and Investment Shares) currently on issue by Livestock Improvement Corporation Limited (LIC), a co-operative company registered under the Co-operative Companies Act 1996 (CCA 1996). The shares will be reclassified into a single, continuing class of shares (Ordinary Shares) listed on the New Zealand Alternative Market Exchange (NZAX).

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

Background

1. LIC was incorporated in 1988 under the Companies Act 1955, and was subsequently reregistered under the Companies Act 1993 (CA 1993) and the CCA 1996. LIC has been a user-owned co-operative since 1 March 2002, and is owned by approximately 10,500 farmers.
2. LIC provides a range of services and solutions to improve the prosperity and productivity of its farmers. This includes dairy genetics, artificial breeding services, information technology systems, herd testing and DNA parentage verification.
3. Currently, LIC customers must purchase at least $500 of LIC's products and services per season to hold a certain number of LIC's shares, based on their expenditure with LIC (the Share Standard). Under the Arrangement, the minimum spend before the Share Standard applies will be increased to $1,000 (although existing Shareholders whose spend is between $500 and $999 will be unaffected until they exceed $1,000, at which point they will become bound by a Minimum Purchases Amount of $1,000).

LIC's existing capital structure

4. In April 2004, LIC implemented a capital structure involving two classes of shares: Co-operative Control Shares and Investment Shares. At that time, LIC had 2,952,859 Co-operative Control Shares on issue and 29,528,590 Investment Shares on issue. The Investment Shares have not increased since then, but (as at 31 May 2017) there are more than 6 million Co-operative Control Shares.

Co-operative Control Shares

5. Each Co-operative Control Share has a nominal value of $1.
6. A farmer purchasing goods and services from LIC must hold a number of Co-operative Control Shares with a nominal value equal to 4% of the aggregate amounts paid (or deemed to be paid) for goods and services purchased from LIC in the preceding season.

7. Co-operative Control Shares carry voting interests. Clause 2.1 of LIC's constitution defines a "Voting Security" as excluding Investment Shares. This ensures that voting interests are only held by transacting shareholders, in accordance with s 33 of the CCA 1996.

8. Co-operative Control Shares carry the right to a Priority Dividend, being a specified percentage of the nominal amount of the share. The specified percentage ¡s set by the Board in each season, and cannot exceed the first mortgage lending rates of LIC's principal bankers in respect of secured loans made to farmers. No other dividend is payable in respect of the Co-operative Control Shares.

9. Since the nominal value of the Co-operative Control Shares is $1, the Priority Dividend (when paid) is always a modest amount. The concept was intended to recompense the farmers for the interest cost they would face ¡n borrowing to purchase the Co-operative Control Shares.

Investment Shares

10. Investment Shares can only be held by persons also holding Co-operative Control Shares (due to LIC being a co-operative company) although a small allocation of Investment Shares is available to LIC employees under an employee incentive scheme.

11. Investment Shares do not carry voting interests (other than certain protective rights and the right to vote on any resolution for the purpose of liquidating LIC).

12. Investment Shares carry dividend rights. Payment of a dividend is subordinate to any Priority Dividend on the Co-operative Control Shares, but that subordination is immaterial given the modest nature of any Priority Dividend.

13. LIC listed on the NZAX in April 2004, to facilitate trading of the Investment Shares (between holders of Co-operative Control Shares). LIC was granted listing with a 'Non-Standard' (NS) designation primarily because of the restrictions on who can hold Investment Shares.

LIC's Available Subscribed Capital (ASC)

14. As at 31 May 2017 the ASC in respect of each class of share was approximately as follows:

- Co-operative Control Shares; $6.24m.
- Investment Shares; $58.46m.

15. This Ruling does not consider or rule upon whether the advised amount of ASC has been correctly calculated.

The proposed capital restructure

16. The Applicant advises that the overall objective of the Arrangement is to create a sustainable capital structure that aligns economic and voting rights. This will be achieved by providing holders of Co-operative Control Shares with a greater economic interest in LIC, while providing holders of Investment Shares with voting rights and requiring Co-operative Control Shareholders to introduce more capital for their greater economic interest.

17. LIC's Board will reclassify the Investment Shares and Co-operative Control Shares into Ordinary Shares on a one-for-one basis. Immediately prior to the Arrangement, each shareholder's holding of Co-operative Control Shares will be adjusted by reference to their expenditure with LIC in the 2017/2018 season in accordance with the Share Standard.

18. The Arrangement involving the equalisation and reclassification of shares will be consistent with relevant provisions in the CCA 1996 and in LIC's constitution concerning co-operative companies.

Equalisation

19. The Co-operative Control Shares have a fixed nominal value of $1, and the Investment Shares have a fluctuating, market-based value (referred to below as $X as at implementation of the Arrangement (Implementation Value)).

20. Accordingly, the value of the Co-operative Control Shares and the Investment Shares will need to be equalised.

Issue of further Co-Operative Control Shares

21. LIC will issue additional $1 nominal value Co-operative Control Shares to existing shareholders.

22. The additional shares are not issued out of existing reserves. The additional Co-operative Control Shares will be nil paid and will become payable when LIC calls for payment. A call for payment will generally coincide with a decision to pay dividends, and each shareholder's outstanding amounts will be offset against any dividend payable.

23. The shareholders do not have an option to elect to take money or money's worth instead of the additional shares, or to require LIC to repurchase those shares.

Implementation Ratio

24. The number of additional nil paid Co-operative Control Shares issued is determined by the ratio of Y:1 (the Implementation Ratio), where:

    Y is equal to "$X - $1":

    $X is the Implementation Value of an Investment Share (as at implementation).

    $1 is the nominal value of a Co-operative Control Share.

    1 is each Co-operative Control Share held prior to implementation.

25. The above steps assume that the valuation of the Investment Shares is a simple (non-fractional) multiple of the nominal $1 value of the Co-operative Control Shares. If this is not the case, then the Implementation Ratio will be applied so as to ensure that a whole number of additional Co-operative Control Shares will be issued.

26. The Implementation Value ($X) will be determined by LIC's Board, with the benefit of an independent adviser's report (which will be made available to shareholders), external financial advice provided to the Board, and taking into account the market price of the Investment Shares as traded on NZAX. Given low trading volumes, the NZAX market price for Investment Shares is not necessarily a reliable indicator of the true market value of Investment Shares.

Subdivision of Investment Shares

27. LIC will then subdivide each Investment Share to ensure that the value of an Investment Share on implementation, having regard to the Implementation Value, equals $1. If, for a particular shareholder, the subdivision calculation does not produce a whole number, the number of Investment Shares will be rounded up to the nearest whole number. The value of each Investment Share will then be equal to the nominal value of each Co-operative Control Share.

28. This will increase the number of Investment Shares by the Implementation Ratio (the same ratio as the increase in Co-operative Control Shares).

29. Upon completion of the above steps, the value of the Investment Shares and the nominal value of the Co-operative Control Shares will have been equalised (albeit with the new Co-operative Control Shares being paid up as to nil). The overall ratio of Investment Shares to Co-operative Control Shares will remain the same as it was immediately prior to implementation.

30. LIC will not elect to treat the share subdivision as a dividend under s CD 8 of the ITA 2007.

Share reclassification

31. After equalisation, all Co-operative Control Shares and Investment Shares will be reclassified as Ordinary Shares. This will occur by way of a constitutional alteration of the rights attaching to the shares.

32. Nil paid Co-operative Control Shares will become nil paid Ordinary Shares.

33. A number of the above steps, including the subdivision of Investment Shares and the reclassification of Co-operative Control Shares and Investment Shares into Ordinary Shares, will need to be approved at a meeting of LIC shareholders. The reclassification will require two resolutions to be passed, one by Co-operative Control Shareholders only, and one by interest classes of each of the Co-operative Control Shareholders and Investment Shareholders.

Issue of and calls on nil paid shares

34. A co-operative company is not required to obtain the consent of a shareholder for the issue of shares imposing or increasing a liability of that person to the company. Accordingly, LIC is able to issue nil paid shares to all holders of Co-operative Control Shares, without the consent of every shareholder.

35. Following reclassification of nil paid Co-operative Control Shares as nil paid Ordinary Shares, the Board will, from time to time, make a call for full payment of the outstanding issue price of one or more nil paid Ordinary Shares held by a shareholder. LIC's constitution allows the Board to "make Calls for the payment of any amounts unpaid on Securities which are not payable at a fixed time or times by the terms of issue of those Securities." The amount of the call is payable at the time specified on the giving of at least ten working days' notice.

36. A call will coincide with the declaration of a dividend. The number of a shareholder's nil paid Ordinary Shares in relation to which a call is made for full payment of the outstanding issue price will be determined by dividing the net cash dividend by the outstanding issue price of the nil paid shares. Any dividends paid on nil paid Ordinary Shares and on any other shares required to be held to satisfy the Share Standard will be applied to repay the outstanding issue price.

Restriction on trading nil paid shares and shareholder-requested calls

37. The Investment Shares are currently traded on the NZAX. After reclassification of all Co-operative Control Shares and Investment Shares into Ordinary Shares, the Ordinary Shares will be traded on the NZAX. There is no practical way to have less than fully paid shares traded on the NZAX, since such shares will have a lesser tradable value than fully paid shares due to the potential for calls on such shares. Consequently, nil paid Ordinary Shares issued by LIC will not be able to be traded on the NZAX until paid in full.
38. The Board reserves the right to approve the transfer of nil paid Ordinary Shares before they have been paid up in full, which it expects to exercise in exceptional circumstances only. In the event that nil paid Ordinary Shares are transferred, the transferee will remain subject to calls for payment in the same way and in the same circumstances as the transferor of those shares. While it will not be a matter within the Company's control, any consideration paid for the transfer of the shares would be expected to take this liability into account.
39. To facilitate trading, shareholders will be able to apply dividends on any additional Ordinary Shares they own to pay up the nil paid Ordinary Shares. They can also make additional payments if they wish to pay up the nil paid Ordinary Shares sooner. Shareholders will need to give notice to LIC in writing if they wish to exercise these rights.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

a) The issue of additional nil paid Co-operative Control Shares will not give rise to a taxable dividend to Co-operative Control Shareholders under subpart CD.

b) The subdivision of the Investment Shares will be a "non-taxable bonus issue" as defined in s YA 1. Accordingly, under s CD 29, the subdivision will not give rise to a dividend to holders of Investment Shares.

c) The reclassification of Co-operative Control Shares and Investment Shares as Ordinary Shares of the same class will not give rise to a taxable dividend under subpart CD.

d) The Arrangement does not involve a disposal of shares by the shareholders. For the purposes of ss CB 1, CB 3, CB 4 and CB 5, no amount is derived by the shareholders as a result of the Arrangement.

e) 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 9 February 2018 and ending on 31 March 2019.

This Ruling is signed by me on the 9th day of February 2018.

Howard Davis
Director (Taxpayer Rulings)

Product Ruling - BR Prd 18/03: Applicant: Bank of New Zealand (BNZ)

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 Bank of New Zealand (BNZ).

Taxation Laws

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

This Ruling applies in respect of:

(a) ss BG 1, CC 7, EW 15, EW 31, GA 1, RE 1 to RE 6, RE 10, RF 1, RF 2, RF 3 and RF 4; and

(b) ss 86F and 86I of the Stamp and Cheque Duties Act 1971 (SCDA).

The Arrangement to which this Ruling applies

The Arrangement is a product (TotalMoney) that BNZ offers to its customers. These customers may only be individuals, companies, or trusts.

TotalMoney involves the creation of new types of accounts that must be in a group of accounts, and the facility to elect to group up to 50 of these new types of accounts into one or more groups to either "pool" or "offset" the account balances.

"Pooling" involves the aggregation of account credit balances to determine the tiered interest rate that will apply to the calculation and crediting of interest to each account balance. "Offsetting" involves the aggregation of account balances to calculate the amount of interest debited to a lending facility account balance.

The Arrangement is set out in the documents listed below, copies of which were received by the Taxpayer Rulings Unit, Inland Revenue, on 22 January 2018:

- Terms and Conditions for your Bank of New Zealand TotalMoney Account for Personal and Sole Trader Customers;
- Terms and Conditions for your Bank of New Zealand TotalMoney Account for Companies and Trusts;
- Bank of New Zealand Home Loan Facility Master Agreement;
- Letter of Advice – TotalMoney Home Loan;
- Facility Document – TotalMoney Business Term Loan;
- BNZ Business Lending Master Terms and Conditions; and
- Confirmation of New Terms and Conditions (for customers converting to TotalMoney).

Further details of the Arrangement are set out in paragraphs 1 to 28 below.

1. TotalMoney is a package of accounts and loans that BNZ offers to its customers. These customers may be only individuals, companies, or trusts.
2. Customers, in general, have a range of accounts with BNZ, including transaction accounts, savings accounts, and various loan accounts. Loan accounts may be only table, non-table, tailored, principal and interest, interest only, fixed or floating home loan accounts, or business loan accounts.
3. TotalMoney allows customers to group or aggregate these accounts for the purposes of either "pooling" or "offsetting" the account balances.

Primary features of TotalMoney

4. The primary features of TotalMoney are the "pooling" and "offsetting" features. These features operate in the manner described below.

Pooling

(a) The pooling aspect of TotalMoney operates when several transaction accounts with credit balances exist. Interest on these credit balance accounts is calculated and paid having regard to the cumulative credit balance of all transaction accounts in the group. Interest-bearing accounts usually attract interest based on interest rate brackets that apply to the balance of each relevant individual account.

BINDING RULINGS

(b) The cumulative credit balance is calculated so BNZ can ascertain the relevant interest rate tier applicable to the relevant accounts. The separate funds are not actually transferred to one account before the interest is calculated. BNZ calculates interest at the applicable interest rate tier that applies to the accumulated balance.

Offsetting

(a) With the offset feature of TotalMoney, interest on a lending facility or facilities within the group is calculated and paid by the customer on the difference between the lending facility balances and the credit balances of transaction accounts in the group. Under the terms and conditions agreed between BNZ and its customers for TotalMoney, BNZ pays no interest on the credit balances that are "offset" against the lending facility.

(b) The "offsetting" is only to calculate the balance of the lending facility or facilities on which interest is payable or, where the credit balances of transaction accounts exceed the balance of the lending facility or facilities in the group in which the credit balances are "offset" against, the balance of the excess credit balances on which interest is receivable. There is no actual transfer of funds, no set-off or netting of funds together in an account, and no transfer of any interest in or entitlement to funds.

5. Every transaction account in a TotalMoney group is automatically either set to "pool" or "offset". If a customer has any lending facilities within their TotalMoney group, the customer's transaction accounts with credit balances are "offset" against their lending facilities. Interest is payable by the customer if the balance of their lending facilities exceeds the balance of their transaction accounts with credit balances, and interest is payable by BNZ if a customer's transaction accounts with credit balances exceeds the balance of their lending facilities. Where the customer has no loan account(s), a customer's TotalMoney accounts will automatically "pool".

6. TotalMoney does not provide a facility for existing accounts. TotalMoney involves the creation of a new type of account. To participate in TotalMoney, a customer must open specific TotalMoney accounts that are particular to the TotalMoney product. Customers may convert an existing non-TotalMoney transaction or savings account that they have with BNZ to a new TotalMoney account. However, the customer must agree that the existing terms and conditions that apply to those accounts cease to apply, and are replaced by the TotalMoney Terms and Conditions.

7. For new TotalMoney accounts, the account will either "offset" or "pool", depending on whether the customer has any lending facilities within the same TotalMoney group.

Pooling – further detail

8. BNZ has a contractual obligation to pay interest if either a customer's transaction accounts with credit balances exceeds their lending facilities within a TotalMoney group, or a customer only has transaction accounts with credit balances (and no lending facilities) within a TotalMoney group. The interest payable is based on the applicable interest rate tier that applies based on the total credit balance being "pooled" or "offset" against any lending facilities in the TotalMoney group. Following usual business practice, BNZ makes a separate determination for withholding tax on each interest payment made to each account.

9. The benefit of the "pooling" feature for customers is that they can earn more interest by combining smaller balances and reaching higher interest-rate tiers and still maintain their money in separate accounts for separate purposes. The customer may consider this an advantageous way to manage their money.

10. Account owners have full deposit and withdrawal access to their transaction accounts. Overdraft facilities may be available in relation to these accounts. However, any overdraft balance is ignored for "pooling" purposes. BNZ charges debit interest on the overdrawn balance of any account. The overdrawn balance does not reduce the "pooled" balance of the credit balance accounts when BNZ is calculating interest for to those accounts.

Offsetting – further detail

11. Where one loan account is in the group, the interest payable on the loan account is calculated on the balance of the loan account less the credit balances of accounts in the group. This will be the case as a matter of law (in terms of TotalMoney documentation) and as a matter of practice (in terms of BNZ's computer system). There is no actual set-off, netting, or transfer of funds, or transfer of any interest in or entitlement to funds. "Offsetting" occurs before debit or credit interest is calculated.

12. For example, in the case of a loan account that would otherwise be the same as a standard variable rate table home loan facility over 20 years with a "minimum payment", there will be no provision for the amount of interest saved under "offsetting" to reduce the "minimum payment". The effect of "offsetting" is the same as a decrease in the floating interest rate and a decision not to reduce the amount of the "minimum payment". In either case, the term of the loan is reduced because the principal portion of the payment is effectively increased. In the case of a non-table loan, interest payments will be reduced by "offsetting", principal repayments will not change, and the loan term will not reduce. In the case of interest only loans, repayments comprise solely interest, so the impact of "offsetting" will be to reduce the interest amount and therefore reduce the "minimum payment".

13. Where there is more than one loan account in the group, the loan accounts in the group are given a default priority; namely, the oldest loan account in the group will receive the highest priority. However, the customer may elect two or more of those loan accounts to be prioritised for "offsetting" purposes. The loan account with the highest priority will receive the benefit of "offsetting" first. It is only where the credit balances of transaction accounts in the group exceed the balance of that highest priority loan account that the next highest priority loan account balance is offset, and so on.

14. If the total credit balances of the transaction accounts are greater than the total debit balance of the loan accounts in a group, credit interest will be applied to the difference and paid on a prorated basis to the credit balance accounts in accordance with the balance of those accounts (essentially in line with the "pooling" feature of TotalMoney).

15. BNZ calculates interest daily. If, during a month, BNZ has both an entitlement to receive interest (that is, the balance of participating loan accounts exceeds the balance of all transaction accounts in a group) and, at another point in the month, BNZ has an obligation to pay interest (that is, the balance of transaction accounts in a group exceeds the balance of the relevant loan accounts), then the two interest payments are made and are not set-off.

16. The "offsetting" feature of TotalMoney essentially offers the same benefits to customers as offered by a revolving credit loan (such as BNZ's "Rapid Repay" product) in terms of lower interest costs and a shorter time to repay the loan. However, this feature overcomes a primary perceived disadvantage of a revolving credit loan because it allows customers to retain separate account balances (which customers may prefer when managing their finances).

17. Where a customer has a TotalMoney loan account, this account must be grouped with at least one other TotalMoney transaction account.

18. No arrangement must exist between the customers who have grouped their accounts that provides for the loan account owner(s) to make a payment(s) to the transaction account owner(s) in consideration for the transaction account owner(s) "offseting" their accounts under TotalMoney.

Business purposes

19. When TotalMoney was established, customers were contractually prohibited from using TotalMoney for business purposes. BNZ has now removed the prohibition on the business use of TotalMoney. BNZ extended the availability of TotalMoney to business customers to give them the same tools for managing their financial affairs as it gives to personal customers.

20. Under the terms and conditions applicable to TotalMoney, customers are able to use TotalMoney accounts for business purposes, which means that, customers are able to group business and non-business product accounts. This means that a sole trader, for example, is able to group their business and non-business accounts.

Terms and Conditions for the TotalMoney home loan products

21. Each of BNZ's home loans is explained in a collection of documents. These documents include primarily a Home Loan Facility Master Agreement (which is a standard form master document that contains generic provisions that apply to all BNZ home loan facilities), and a Letter of Advice for Home Loans (which contains particular and specific provisions for the home loan facility being made available to the customer and overrides the Loan Facility Master Agreement in case of any inconsistencies). The Letter of Advice is produced from a computer system that contains a master list of possible provisions that can apply to BNZ's home loans. Under this system, the provisions applicable to a particular home loan are selected, collated, and produced in a document.

22. The TotalMoney product home loans are also documented in a Home Loan Facility Master Agreement and Letter of Advice for Home Loans.

23. Table loans provide for regular payments and a set date when they will be paid off. Most payments early in the loan term comprise interest, while most of the payments later in the term comprise repayments of the principal. Non-table loans have two separate repayments, one of interest and one of principal. Customers repay the same amount of principal each time and interest is charged separately.

24. The documentation for a TotalMoney standard variable rate table home loan facility over 20 years will largely be the same as that for current BNZ home loan facilities that are standard variable rate table home loans over 20 years. The only differences are; branding (the name on the Letter of Advice), the interest calculation (which provides for the effect of the "offset"), and, in relation to table loans, the provision stating that where the loan has the benefit of the "offset" to reduce the interest cost, the "minimum payment" specified for the loan will not decrease because of any interest savings but instead the loan term will reduce. Under a non-table loan, any interest saving (whether as a result of a reduction in the applicable interest rate because of a general decrease in interest rates or because of the offset feature), would result in either a reduction of the interest repayment of the loan or a reduction in the loan term (if the original repayment amount is maintained despite the interest saving). In relation to a TotalMoney product home loan that is a table home loan, a reduction is only allowed in the loan term. Under a TotalMoney product interest only loan, any interest saving (whether as a result of a reduction in the applicable interest rate because of a general decrease in interest rates, or because of the offset feature) would result in a reduction of the interest repayment.

Terms and conditions for TotalMoney business loan products

25. Each of BNZ's business loans is also documented under a collection of documents. These include primarily the Business Lending Master Terms and Conditions (a standard form "Master" document which contains primarily generic provisions that apply to BNZ's business loan facilities) and a Business Term Loan Facility Document (which contains particular and specific provisions for the loan facility that is being made available to a TotalMoney business customer). To the extent that there are any inconsistencies between the documentation, BNZ has the sole discretion to resolve the inconsistency.

Groups

26. TotalMoney is based on a group of participating accounts. Groups can be comprised of only of the following categories:
    - (a) Natural persons:
        - (i) The accounts of an individual, or the individual and joint accounts of married, de facto, and civil union couples, and any of their children may be combined as part of one group of accounts.
        - (ii) For example, the various accounts of one natural person, Jane, or, the various accounts (individual or joint) of Jane and her husband John and their child Joe. The group is not limited to residents of New Zealand, although the group may not include both residents and non-residents.
    - (b) One company or one trust:
        - (i) Multiple accounts of one company (including a qualifying company or look through company) or one trust may be combined as part of a group. Only one entity can be in a group at any time.
        - (ii) Accounts of different entities (including the entity and any related individual) cannot be pooled or offset.
27. Accounts may only be included in one group. An individual may have accounts in three groups, through membership in one as an individual customer, the second as a joint customer and in the third as a sole trader. A group may not include more than one sole trader's accounts.
28. A customer may be a resident or non-resident of New Zealand for tax purposes. However, where a group of accounts consists of accounts owned by more than one legal person, BNZ will obtain representations from the owners of those accounts that they do not have different tax residence status. That is, where more than one legal person is participating in a group of accounts, either all persons must be residents of New Zealand for tax purposes or all persons must be non-residents of New Zealand for tax purposes.

BNZ's objectives

29. BNZ's objectives in providing TotalMoney are to:
    - (a) increase its market share, particularly for home loans and transaction-type accounts;
    - (b) increase customer satisfaction and customer retention; and
    - (d) improve its brand awareness and be seen as a market leader.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following condition:

(a) All interest rates related to the TotalMoney product are arm's length market interest rates.

How the Taxation Laws apply to the Arrangement

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

Financial arrangements rules

(a) When a credit balance of a transaction account and a debit balance of a loan account are "offset", there is no amount of consideration paid or payable because of that "offset" for the calculation of income and expenditure under ss EW 15 and EW 31 of the "financial arrangements rules" (as defined in s EW 1(2)).

Resident Withholding Tax (RWT), Non-Resident Withholding Tax (NRWT) and Approved Issuer Levy (AIL)

(b) Under the "pooling" feature of TotalMoney:

   (i) RWT (as defined in s YA 1) and NRWT (as defined in s YA 1) must be deducted by BNZ from the interest credited to the participating transaction accounts in a group in accordance with the RWT rules (as defined in ss RE 1(1) and YA 1) and the NRWT rules (as defined in ss RF 1(1) and YA 1);

   (ii) For an account that is a "registered security" (as defined in s 86F of the SCDA), "approved issuer levy" (as defined in s 86F of the SCDA) may be paid by an "approved issuer" (as defined in s 86F of the SCDA) for the interest credited to that account pursuant to s 86I of the SCDA.

(c) Under the "offsetting" feature of TotalMoney:

   (i) There is no payment of or entitlement to "interest" (as defined in s YA 1) for the credit balances of participating transaction accounts in a group, and no obligation to deduct RWT or NRWT or pay AIL, except to the extent that the combined credit balance of those accounts exceeds the combined debit balance of the lending facility accounts.

   (ii) To the extent that interest is credited to participating transaction accounts in a group:

   - RWT (as defined in s YA 1) and NRWT (as defined in s YA 1) must be deducted by BNZ from the interest credited to the participating transaction accounts in a group in accordance with the RWT rules (as defined in ss RE 1(1) and YA 1) and the NRWT rules (as defined in ss RF 1(1) and YA 1);
   - For an account that is a "registered security" (as defined in s 86F of the SCDA), "approved issuer levy" (as defined in s 86F of the SCDA) may be paid by an "approved issuer" (as defined in s 86F of the SCDA) for the interest credited to that account pursuant to ss 86F and 86I of the SCDA.

Section CC 7

(d) No income arises under s CC 7 for BNZ or its customers in relation to the Arrangement.

Section BG 1

(e) 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 1 April 2018 and ending on 31 March 2022.

This Ruling is signed by me on the 29 March 2018.

James Mulcahy
Group Lead, Customer Compliance – Significant Enterprises

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 18/07: When is an arrangement considered to be "materially different" from the arrangement identified in a private or product ruling?

This question we've been asked (QWBA) will be of interest to anyone who has been issued a binding private or product ruling where differences exist between the arrangement described in the ruling and the arrangement implemented.

This QWBA explains when the Commissioner will consider an arrangement to be materially different from the arrangement identified in a private or product ruling.

Key terms in this item

This QWBA relates to **private rulings** and **product rulings**.

A **private ruling** provides certainty to the person(s) referred to in the ruling about how the Commissioner will apply relevant taxation laws to the person(s) in relation to an arrangement.

A **product ruling** provides certainty to consumers of a particular product about how the Commissioner will apply relevant taxation laws to them in relation to the arrangement to which they are a party.

An **arrangement** is a contract, agreement, plan or understanding (whether enforceable or not), including all steps and transactions by which it is carried into effect. It includes facts that the Commissioner considers are material or relevant as background or context to a private or a product ruling.

Question

When is an arrangement (the revised arrangement) considered to be "materially different" from the arrangement identified in a private or product ruling for the purpose of ss 91EB(2)(a) and 91FB(2)(a) of the Tax Administration Act 1994 (TAA)?

Answer

The revised arrangement is "materially different" for the purpose of ss 91EB(2)(a) and 91FB(2)(a) of the TAA if, in relation to a tax type, the difference between the revised arrangement and the arrangement identified in the ruling is capable of affecting the tax outcome referred to in the ruling.

Whether the revised arrangement is materially different from the arrangement identified in the ruling will be considered on a case-by-case basis, because it will turn on the facts and circumstances of each case.

Explanation

1. Section 91EB(2) of the TAA sets out the instances in which a private ruling does not apply to a person in relation to a tax type for an arrangement. One such instance is if the arrangement is "materially different" from the arrangement identified in the ruling. Section 91EB(2)(a) states:

> (2) A private ruling does not apply to a person in relation to a tax type for an arrangement, to the extent to which, in relation to the tax type —
>
> (a) the arrangement is **materially different** from the arrangement identified in the ruling;... [Emphasis added]
>
> ...

2. Section 91FB(2)(a) of the TAA contains an equivalent provision in relation to product rulings.
3. We have been asked to provide guidance on the meaning of "materially different" in ss 91EB(2)(a) and 91FB(2)(a).
4. To provide this guidance, we must consider the meaning of the terms "materially" and "different". The *Oxford English Dictionary* (online ed, Oxford University Press, accessed 13 February 2017) relevantly defines these two terms (and their derivatives) as follows:

> **Materially adv. ... 4** To a material or important extent; significantly, substantially, considerably. ...

> **Material adj.** (specifically in the context of "having significance or relevance") … **6a** Of serious or substantial import; significant, important, of consequence. … **6c** Of evidence or a fact: significant or influential, esp. in having affected a person's decision-making; … **6d** Pertinent, relevant; essential.
>
> **Different adj. … 2a** Unlike in nature, form, or quality; not of the same kind; dissimilar.
>
> **Differ v. 1** To have different or distinguishing qualities or features; to be dissimilar, different, or distinct in nature, form, or qualities in a particular respect.

5. Therefore, based on these definitions, a "materially different" arrangement is one that is significantly unlike the arrangement identified in the ruling, with that difference being of consequence or influential in affecting a person's decision-making.

6. No New Zealand case law has considered the meaning of "materially different" in a tax context.

7. The Australian Federal Court considered the meaning of the phrase in *Carey v Field* [2002] FCA 1173. The case was an application for judicial review of the Australian Commissioner's decision to withdraw a product ruling (a type of public ruling) in the context of the original Australian binding rulings regime (since repealed and replaced). The court was required to consider whether, on the material before the Commissioner and upon which he relied, it was open to him to conclude that the differences he identified as "material differences" were considerations that he was entitled to take into account in deciding to withdraw the product ruling. The real issue between the parties related to what constitutes a "material difference" in that context. The relevant legislation contained no reference to the phrase "materially different". However, the product ruling contained the following statement:

> If the arrangement described in the Product Ruling is **materially different** from the arrangement that is actually carried out, investors lose the protection of the Product Ruling. [Emphasis added]

8. The applicant submitted that for a difference to be material, the difference **must** result in a different tax outcome to that provided for in the ruling. Merkel J disagreed and expressed the following views at [47]:

> … In my view if it is reasonably open to the Commissioner to form the view on the material before him that, because of a difference between the arrangement implemented and that ruled upon, the tax outcome for a taxpayer who is a member of the class of persons to whom the ruling was intended to apply is capable of being, or is or likely to be, different to that provided for in the ruling, that difference is a material difference, and therefore not an irrelevant consideration in the context of the judicial review of a decision to withdraw the ruling under s14ZAAK(1) of the [Taxation Administration Act 1953 (Cth)]. While a purpose of the binding public ruling system is to provide certainty to taxpayers, that purpose is better served by the Commissioner having the power to withdraw a ruling if he forms the view that the differences between the arrangement implemented and that ruled upon are capable of having or likely to have a different tax outcome to that provided for in the ruling. Plainly, if it is reasonably open to the Commissioner to form the view that the tax outcomes ruled upon do not apply, greater certainty is provided by the withdrawal of the ruling. The object of certainty and the public interest are not served by the maintenance of a ruling where the Commissioner has formed a view, that is reasonably open on the basis of the material before him, that the ruling can no longer be safely relied upon because of differences between the arrangement implemented and that ruled upon.

9. In other areas of law, the courts have held that a difference is "material" if it is significant or relevant (*Rainey v Greater Glasgow Health Board* [1987] 1 All ER 65 and *Minister for Immigration, Local Government and Ethnic Affairs v Dela Cruz* (1992) 110 ALR 367). In the context of contracts in writing and written instruments, a material alteration is one that alters the legal effect of the instrument (*Vacuum Oil Co Pty Ltd v Longmuir* [1957] VR 456). Given the very different context in which these cases were decided, it is the Commissioner's view that they are of very limited interpretative value.

10. In the context of the New Zealand binding rulings legislation, it is the Commissioner's view that the phrase "materially different" in ss 91EB(2)(a) and 91FB(2)(a) means a difference that is **capable** of affecting the tax outcome referred to in the ruling.

11. Therefore, if in relation to a tax type, the difference between the revised arrangement and the arrangement identified in the ruling is capable of affecting the tax outcome referred to in the ruling, the Commissioner's view is that the revised arrangement is "materially different" from the arrangement identified in the ruling for the purpose of ss 91EB(2)(a) and 91FB(2)(a).

12. Whether a revised arrangement is materially different from the arrangement identified in a private or product ruling depends on the facts and circumstances of each case. The size of the difference in tax outcome is not a determining factor when evaluating whether the difference in the arrangement is material for the purpose of ss 91EB(2)(a) and 91FB(2)(a). In certain instances the size of the difference in tax outcome will not be a relevant factor at all. Given the widely divergent nature of the taxation laws in respect of which binding rulings may be made, it is not possible to list all the factors that the Commissioner will take into account when considering each case. The Commissioner will consider each matter on a case-by-case basis.

When the ruling ceases to apply under ss 91EB(2)(a) and 91FB(2)(a) of the TAA

13. It is the Commissioner's view that, if a revised arrangement is materially different from the arrangement identified in a ruling, the ruling does not apply in relation to the tax type for the arrangement from the point in time that the arrangement is materially different. The ruling will continue to apply from commencement of the period of the ruling until that point.

Process

14. If you have a question about whether an arrangement is materially different from the arrangement identified in a private or product ruling you should contact:
    - your Compliance Manager if you are a Significant Enterprise taxpayer; or
    - the team that worked on your ruling; or
    - the Taxpayer Rulings Unit of the Office of the Chief Tax Counsel (rulings@ird.govt.nz).

    You may be required to apply for a new ruling to enable the Commissioner to consider whether the revised arrangement is materially different from the arrangement ruled on.

Examples

The following examples help to explain the application of the law.

Example 1: Using a different investment vehicle

Shane, Karen and Steve intend to use a limited partnership structure to invest in a commercial property development. They obtain a private ruling about the tax treatment of interest paid and tax losses. However, they end up using a look-through company structure instead of a limited partnership structure for their investment.

The Commissioner considers the revised arrangement is materially different from the arrangement identified in the ruling, because the investment vehicle used is capable of affecting the tax outcome identified in the ruling.

Example 2: Loan financing provided by a different bank on identical terms

No 8 Wire Limited is in negotiations with ABC Bank (a New Zealand bank) to obtain a loan for $5 million to acquire new business equipment for its factory in New Plymouth. No 8 Wire Limited obtains a private ruling to confirm that interest payments under the proposed loan contract with ABC Bank will be deductible for income tax purposes. The loan falls through shortly after the private ruling is issued, but No 8 Wire Limited is able to secure a $5 million loan on identical terms from XYZ Bank (also a New Zealand bank).

The Commissioner considers that the arrangement is not materially different from the arrangement identified in the private ruling issued to No 8 Wire Limited because the difference in the arrangement is not capable of affecting the tax outcome identified in the private ruling.

Example 3: Acquiring shares in a different company listed on the ASX

Marama is a share dealer with a significant share portfolio. She intends to acquire a portfolio interest in Technotrooper, a foreign company listed on the ASX. She obtains a private ruling that dividend income derived from this company is not income, so is not taxable. The ruling is on the basis that this investment is an attributing interest in a foreign investment fund (FIF) in relation to which the fair dividend rate method will be used to calculate Marama's FIF income, and none of the exemptions in ss EX 31 to EX 43 will apply to her proposed shareholding in Technotrooper.

Shortly after obtaining the private ruling, Marama decides to acquire a portfolio interest in GadgetsGalore instead. GadgetsGalore is also listed on the ASX.

The Commissioner considers that the arrangement is materially different from the arrangement identified in the private ruling, because the tax outcome is capable of being different to that provided for in the private ruling that Marama obtained. Shares listed on the ASX may be eligible for the exemption in s EX 31.

If Marama's rights in GadgetsGalore meet the requirements in s EX 31 it will be exempt from being an attributing interest in a FIF, and no FIF income will arise. However, if Marama's rights in GadgetsGalore do not meet the requirements in s EX 31 it will not be exempt from being an attributing interest in a FIF, and FIF income may arise in Marama's hands if all the other relevant requirements in s CQ 5 are met.

Example 4: Difference affects only one of the sections ruled on

Bric-a-Brac Limited obtains a private ruling in respect of how ss CA 1, CB 1, CB 2, CB 3, CB 4, CB 5 and CX 55 of the Income Tax Act 2007 apply to an arrangement. The arrangement subsequently implemented is different from the arrangement identified in the ruling. The difference is capable of affecting how s CX 55 applies to the arrangement but is not capable of affecting how any of ss CA 1, CB 1, CB 2, CB 3, CB 4, or CB 5 apply to the arrangement.

Section 91EB(2)(a) of the TAA provides that a "private ruling does not apply to a person **in relation to a tax type** for an arrangement, to the extent to which, **in relation to the tax type**, the arrangement is materially different from the arrangement identified in the ruling".

While the private ruling contains ruling bullet points in relation to multiple sections relating to income tax, the private ruling is in relation to only one tax type (that is, income tax). As the difference between the arrangement identified in the ruling and the arrangement implemented is capable of affecting the tax outcomes ruled on, the ruling does not apply in relation to the relevant tax type (being income tax) for the arrangement. As the ruling was in relation to only one tax type (being income tax), the entire ruling does not apply.

Example 5: Difference affects tax outcome not ruled on

Bubble and Squeak Limited obtains a private ruling in relation to how ss CW 10 and CX 55 of the Income Tax Act 2007 apply to an arrangement. The arrangement as implemented differs from the arrangement ruled on. However, the differences are not capable of affecting the tax outcomes ruled on – the differences are capable of affecting only the tax outcome in relation to s IC 5 (which was not ruled on).

It is the Commissioner's view that the arrangement is not "materially different" for the purpose of s 91EB(2)(a) of the TAA in these particular circumstances. This is because the differences between the arrangement ruled on and the arrangement implemented are not capable of affecting the tax outcomes **ruled on**.

Example 6: Difference affects only one of the tax types ruled on

Pitter Patter Limited obtains a private ruling that contains ruling bullet points in relation to income tax and ruling bullet points in relation to GST. The difference in the arrangement ruled on and the arrangement implemented is capable of affecting the GST outcome ruled on, but is not capable of affecting the income tax outcome ruled on.

Under s 91EB(2)(a) of the TAA a "private ruling does not apply to a person **in relation to a tax type** for an arrangement, to the extent to which, **in relation to the tax type** the arrangement is materially different from the arrangement identified in the ruling".

Therefore, it is the Commissioner's view that the private ruling does not apply to Pitter Patter Limited in relation to GST for the arrangement. This is because, in relation to the GST tax type, the difference between the arrangement identified in the ruling and the arrangement implemented is capable of affecting the manner in which the GST legislation ruled on applies to the arrangement. The private ruling continues to apply to Pitter Patter Limited and the arrangement in relation to the income tax legislation ruled on.

Example 7: Difference may affect conclusion under s BG 1 of the Income Tax Act 2007

Property Projects Limited applies for and obtains a private ruling in relation to a new business venture that it is about to launch. The description of the arrangement contains a statement to the effect that Property Projects Limited uses, and will continue to use, IFRS. In the absence of that statement the Commissioner would not be able to rule as requested in relation to s BG 1 of the Income Tax Act 2007.

Shortly after the private ruling is issued the IFRS thresholds are modified. Those falling under/outside the new thresholds are now able to choose whether to use IFRS or GAAP. Property Projects Limited chooses to continue using IFRS.

As Property Projects Limited continues to use IFRS following the modification of the IFRS thresholds, the statement of fact contained in the description of the arrangement holds true. Therefore, it is the Commissioner's view that the arrangement remains the same as that identified in the ruling.

If Property Projects Limited starts using GAAP instead of IFRS following the modification of the IFRS thresholds, it is the Commissioner's view that the revised arrangement is materially different from the arrangement identified in the private ruling as it is capable of affecting the tax outcome referred to in the ruling.

References

Subject references

materially different

Legislative references

Tax Administration Act 1994 – ss 91EB(2)(a) and 91FB(2)(a)

Case references

Carey v Field [2002] FCA 1173

Minister for Immigration, Local Government and Ethnic Affairs v Dela Cruz (1992) 110 ALR 367

Rainey v Greater Glasgow Health Board [1987] 1 All ER 65

Vacuum Oil Co Pty Ltd v Longmuir [1957] VR 456

Other references

Oxford English Dictionary (online ed, Oxford University Press), accessed 13 February 2017

LEGISLATION AND DETERMINATIONS

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

Determination CRS 2018/006: CRS applied standard – excluded account determination – share purchase scheme account maintained by CRS Nominees Limited

Reference

This determination is made under section 91AAW of the Tax Administration Act 1994.

Interpretation

In this determination, unless the context otherwise requires:

"Benefit" means the value of a benefit that an employee receives under a share purchase scheme.

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

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

"CRS reporting period" means the period from 1 July 2017-31 March 2018 and any subsequent period from 1 April-31 March.

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

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

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

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

"Employee" means (depending on the context) an employee of Fletcher Building Limited (FBL), Genesis Energy Limited (GEL), or Meridian Energy Limited (MEL).

"Employer" means (depending on the context) FBL, GEL, or MEL.

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

"Good leaver" means when an employee with a share purchase scheme account leaves the share purchase scheme in any of the following situations – death, illness, injury, disability, redundancy, retirement (where required by the employer), or the relevant part of the employer being sold, closed down or otherwise ceases to be part of the employer.

"Share purchase scheme" means a share purchase scheme maintained by CRS Nominees Limited for an employee of any of the following companies:

- FBL;
- GEL; or
- MEL.

"Share purchase scheme account" means a share purchase scheme financial account maintained by CRS Nominees Limited for an employee of any of the following companies:

- FBL;
- GEL; or
- MEL.

Discussion (which does not form part of the determination)

CRS Nominees Limited (a wholly owned subsidiary of Computershare Investor Services Limited) acts as nominee and trustee in respect of the shares purchase schemes created by FBL, GEL, and MEL. FBL, GEL and MEL are listed on the NZX Main Board and are not in the business of providing financial services to customers.

CRS Nominees Limited's role is to hold the legal title to the equity securities (being ordinary shares in FBL, GEL and MEL) on behalf of employees that participate in the share purchase schemes.

CRS Nominees Limited is a Reporting New Zealand financial institution for CRS purposes.

Scope of determination

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

This is determination is issued subject to the following conditions being satisfied (in relation to CRS Nominees Limited, each of the respective employers, each of the share purchase schemes, and each of the share purchase scheme accounts):

- The employer administers the share purchase scheme, and is not a financial institution under the CRS applied standard;
- CRS Nominees Limited holds the legal title to the shares as trustee of the trust established by the employer for the purposes of the share purchase scheme;
- The employer remains subject to applicable disclosure requirements under both the NZX Listing Rules and the Companies Act 1993;
- The share purchase scheme accounts are available to all of the employees of the employer on the same basis;
- The employee contributions to the share purchase scheme accounts are limited to the following amounts:
  - $5,000 per year (deducted from payroll);
  - any dividends declared by the employer companies that are reinvested in the share purchase schemes (for employees of FBL and GEL);
  - any bonus issues made subject to the share purchase schemes; and
  - any renounceable rights issues (or other forms of capital re-organisation) that are required to be cashed up and the proceeds used to subscribe for ordinary shares in the share purchase schemes.
- The employer contributions to the share purchase scheme account on a "2 for 1 basis". This applies as follows (depending on who the employer is):
  - **FBL**: The employer contributes 1 "award share" to the account for every 2 shares that the employee acquires (with their employee contribution).
  - **GEL**: The employer contributes 1 "award share" to the account for every 2 shares that the employee acquires (with their employee contribution).
  - **MEL**: The employer contributes a $1 "award amount" for every $2 that the employee contributes to the account.

An employee is generally only able to receive the full benefit of the employer contributions to the share purchase account upon holding the account for three years.[1] The only exception to this is if they are a "good leaver";

- All benefits provided to the employees in relation to the share purchase scheme accounts are reported to Inland Revenue; and
- The total contributions (employer and employer) to the share purchase scheme accounts are limited to USD 50,000 per CRS reporting period. This includes the following amounts which may (depending on the context) be contributed to the account:
  - Employee contributions;
  - Award shares; and
  - Award amounts.

[1] The MEL share purchase scheme provides that the employer's contribution is broken down into two parts, firstly a cash bonus provided that the shares are held for the 3 year qualifying period and secondly, a cash performance award bonus provided that MEL's total shareholder return exceeds the average for the industry. In other words, an employee of MEL that holds a share purchase scheme account will only be eligible to receive the full "cash bonus", if MEL achieves defined performance requirements.

Determination

A share purchase scheme account, as defined in this determination, is an excluded account for the purposes of the CRS applied standard and the requirements under Part 11B of the Tax Administration Act 1994. If any of the above conditions are not satisfied for a particular share purchase scheme account this determination will not apply to that account (i.e. the account will not be an excluded account).

Application date

This determination applies for the CRS reporting period 1 July 2017 to 31 March 2018, and subsequent CRS reporting periods under the CRS applied standard.

Dated at Hamilton this 29th day of March 2018

Tony Morris
Customer Segment Lead, Significant Enterprises Customer Segment

Special Determination S57: Valuation of shares issued by Bank on conversion of Notes

This Determination may be cited as *Special Determination S57: Valuation of shares issued by Bank on conversion of Notes.*

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

1.1 This determination relates to a funding transaction involving the issue of Notes by Bank to Group Member pursuant to a Deed Poll. The Notes will contain a conversion mechanism to allow them to be recognised as Tier 2 capital for the purposes of the Reserve Bank of New Zealand framework relating to the capital adequacy of banks.

1.2 The funding transaction is the subject of private ruling BR Prv 18/09, issued on 26 March 2018 and is fully described in that ruling.

1.3 The agreement to subscribe for shares provided for in the Deed Poll is a financial arrangement (as defined in s EW 3) and an "agreement for the sale and purchase of property or services" (as defined in s YA 1). The Notes and the agreement to subscribe for shares are, together, part of a wider financial arrangement.

2. Reference

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

3. Scope of determination

3.1 This determination applies to a funding transaction involving the issue of Notes by Bank to Group Member pursuant to a Deed Poll.

3.2 If an event requiring conversion of the Notes occurs, the relevant number of Notes must be immediately and irrevocably converted. In summary, the steps for the conversion of the Notes will be as follows:

(a) Bank will issue a specified number of ordinary shares in Bank to Group Member for each Note to be converted.

(b) Group Member's rights in relation to each Note to be converted will be immediately and irrevocably terminated for an amount equal to the Issue Price of the Note to be converted. Bank will apply this amount by way of payment for the subscription of the ordinary shares referred to in paragraph (a).

3.3 This determination applies if shares are issued by Bank on a conversion of the Notes to determine the value of the shares for the purposes of the financial arrangements rules.

4. Principle

4.1 The Notes and the subscription for shares are, together, part of a financial arrangement (as defined in s EW 3). The agreement to subscribe for shares in Bank by Group Member is an "agreement for the sale and purchase of property and services" (as defined in s YA 1), because it is a conditional agreement to acquire property.

4.2 The agreement to subscribe for shares is not a "short-term agreement for sale and purchase" (as defined in s YA 1), because settlement is not required to occur within 93 days. Therefore, the agreement to subscribe for shares is not an excepted financial arrangement under s EW 5.

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

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

5. Interpretation

In this determination, unless the context otherwise requires:

- All legislative references in this determination are to the Income Tax Act 2007, unless otherwise stated.
- **Bank** means the bank issuing the Notes.
- **Group Member** means a member of the same "wholly-owned group of companies" (as defined in s YA 1) as Bank.
- **Notes** means the Notes issued to Group Member pursuant to the Deed Poll described in private ruling BR Prv 18/09.

6. Method

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

6.2 For the purposes of s EW 32(6), the value of the shares issued by Bank is equal to the amount Group Member paid for those shares.

7. Example

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

Following an event requiring conversion, Notes having an Issue Price of $100 are to be converted into ordinary shares in Bank. Bank immediately pays an amount equal to the Issue Price of the Notes to Group Member for termination of Group Member's rights under the Notes. This amount is automatically applied on Group Member's behalf to subscribe for ordinary shares in Bank. Bank issues the number of shares to Group Member calculated in accordance with the formula in the terms of the Notes. The value of the shares, for the purposes of s EW 32, is $100.

This Determination is signed by me on the 26th day of March 2018.

Fiona Heiford
Manager, Taxpayer Rulings

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 18/02: Requests to change a balance date

Introduction

Standard practice statements 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 Standard Practice Statement (SPS) sets out Inland Revenue's practice for considering requests for the Commissioner's approval to change a balance date for income tax purposes. The description "non-standard balance date" in this SPS refers to a balance date other than 31 March.

This SPS applies to all requests for a change of balance date. It includes requests from customers who wish to change from a 31 March balance date to a non-standard balance date; requests to change from one non-standard balance date to another non-standard balance date and also requests to change from a non-standard balance date to a 31 March balance date.

Section references are to the Tax Administration Act 1994 unless otherwise stated.

Application

This SPS applies from 1 April 2018. It replaces *SPS 08/04: Elections to change a balance date* which was published in *Tax Information Bulletin* Vol 20, No 11 (February 2009).

Standard practice

Summary

1. The Commissioner has an obligation to protect the integrity of the tax system, including applying the tax laws fairly, impartially and according to the law. Every request will be considered on its individual merit in line with this SPS.
2. Section 38 allows the Commissioner to agree that customers may be permitted to file an income return for the year ending on the date corresponding with the balance date of their annual accounts, instead of using the standard 31 March balance date provided by the Tax Administration Act 1994.
3. Only customers with an obligation to file returns under s 33 (generally, customers in business or those who receive income not taxed at source) may apply under s 38 to adopt a balance date other than 31 March.
4. Subject to the detailed discussion in this SPS, approval will be provided where the Commissioner is satisfied the change is not for reasons as outlined at [12].

Detailed discussion

Overview of the authority to change a balance date

5. When a customer wishes to adopt a non-standard balance date, or change from a non-standard balance date back to 31 March (or change from one non-standard balance date to another), they are required to obtain the Commissioner's prior notified approval under s 38 before they can file a return for that new balance date.
6. Section 38 reads as follows:

> **38(1) [Returns to annual balance date]** Instead of furnishing a tax year return under section 33 on the basis of a corresponding income year that ends on 31 March, a taxpayer (other than a person who meets the requirements of section 33A(1), or is issued an income statement or required to request or be issued an income statement,) may, with the consent of the Commissioner, elect to furnish a return based on a corresponding income year that ends with the date of the annual balance of the taxpayer's accounts.

STANDARD PRACTICE STATEMENTS

> **38(1B) [When multi-rate PIE must not make election]** A multi-rate PIE that does not calculate and pay tax using the provisional tax calculation option under section HM 44 of the Income Tax Act 2007 must not make an election under subsection (1).
>
> ...
>
> **38(3) [Prior notified approval required for change of election]** Any election made by a taxpayer for the purposes of this section shall continue in force unless and until it is altered by the taxpayer with the prior notified approval of the Commissioner.

7. A 31 March balance date is the default for a "tax year" in s 33, and s YA 1 of the ITA 2007 defines "tax year" as a period starting 1 April and ending 31 March. However, s 38(1) lets the Commissioner approve the filing of tax returns for a tax year that does not end on 31 March. The legislation provides no further guidance on how to use this discretion.

When will the Commissioner agree to a change in balance date?

8. Subject to the detailed discussion in this SPS, approval will be provided where the Commissioner is satisfied the change is not for reasons as outlined at [12] and that a customer is able to provide a correct return of income for a tax year ending on the balance date.

9. The Commissioner acknowledges there are situations where a balance date of 31 March may be impractical. The situations described below are not intended to be an exhaustive list and there are likely to be other circumstances (not contemplated in the SPS) where it would be appropriate to agree to a change to a balance date. The Commissioner will agree to a change to a balance date for customers to:
   (a) adopt an alternative balance date when they can demonstrate that the nature of their business makes a 31 March balance date impractical, or their circumstances have changed significantly and they should be permitted to change a non-standard balance date previously agreed to (this includes elections by new business customers to adopt a non-standard balance date, with application from their first return/tax year);
   (b) adopt an alternative balance date when they can demonstrate that unreasonable or excessive compliance costs will be incurred as a consequence of having to return income to 31 March (this may include the impact of other statutory reporting requirements, see further comment at [15] and [16]);
   (c) align with an agreed industry balance date (see further comment at [23] to [29]);
   (d) allow a franchisee who is required as a condition of a franchise agreement to use a non-standard balance date for financial reporting purposes, where the applicable balance date has been recognised via an agreement between the Commissioner and the master franchisor;
   (e) allow a shareholder-employee to use the same balance date as the company from which they derive their primary source of income;
   (f) allow a customer who receives passive income, and therefore has an obligation to provide a return of income to 31 March for that passive income as well as any business income that they earn, to adopt a non-standard balance date for returning their business income. If the business income has a source in a related business entity, a customer may elect to return income to the balance date of that related entity (see further comment at [17] to [20]);
   (g) allow a subsidiary company to use the same balance date as the parent company;
   (h) adopt a common balance date for business entities with a close working relationship, where they share a common business/management accounting system or central administration structure and one of those entities has an approved non-standard balance date. This category includes joint ventures that want to adopt a balance date common with a partner;
   (i) allow managed funds to adopt a balance date in common with a fund manager or trustee when it can be demonstrated that a parent–subsidiary-like relationship exists between parties, excluding a multi-rate portfolio investment entity ("multi-rate PIE") that does not make tax payments under s HM 44 of the ITA 2007 (see further comment at [30]);
   (j) allow entities deemed to be agents of non-resident insurers to file "as agent" returns in terms of s HD 16 of the ITA 2007, excluding a multi-rate PIE that does not make tax payments under s HM 44 of the ITA 2007;
   (k) adopt a balance date applicable to a non-resident customer's tax jurisdiction, when they perform business activities in New Zealand but have a centre of management outside New Zealand (does not apply to non-residents that merely earn passive investment income in New Zealand);
   (l) allow an estate to adopt the date that coincides with the date of death of the deceased customer as the balance date for the continuing estate;

(m) allow a previously tax-exempt entity to continue to use a balance date consistent with an existing date for financial reporting purposes (eg, a charity that previously had only exempt income and so was not required to file tax returns but is now required to file returns, may continue to use the non-standard balance date they had used prior to entering the tax base).

10. When agreeing to a change to a balance date, the Commissioner will only agree to an annual balance date that is the last calendar day of a month rather than part-way through a month. However, there is an exception for a continuing estate that elects to adopt a balance date that coincides with a deceased taxpayer's date of death.

11. Where the Commissioner has already provided consent to a balance date other than the last calendar day of a month, these consents will not be revisited unless a further request to change a balance date is received. Similarly, in these situations subsidiary entities will be permitted to adopt the non-standard balance date of a parent entity.

When will the Commissioner not agree to a change in balance date?

12. The Commissioner will not agree to a change in balance date when:
    (a) a reason for the change is to defer the payment of tax, or to take earlier advantage of a tax incentive or concession than would otherwise not have been the case had no change of balance date occurred;
    (b) the request has been made because of a wish to smooth out administrative workloads within the customer's business (setting aside matters relating to seasonal businesses);
    (c) the non-standard balance date is the anniversary date of the commencement of the business, unless that date coincides with an agreed industry balance date;
    (d) the request is made to smooth the workflow of a manager, or trustee, or tax agent;
    (e) the customer has investment income and no direct involvement in a business activity (see further comment at [17] to [20]);
    (f) functions have been contracted out to a third party (eg, a specialist administration manager) and the customer wishes to adopt the manager's balance date
    (g) a multi-rate PIE that does not make tax payments under s HM 44 of the Income Tax Act 2007 ("ITA 2007") cannot have a balance date other than 31 March.

Consideration of requests

13. In considering a request to change a balance date the Commissioner will look at relevant matters, consistent with the statutory responsibilities under s 6 to maintain the integrity of the tax system.

14. The supporting information in a request to change a balance date will be considered. The Commissioner's considerations may extend to other relevant information held for a customer and of wider industry practice, to establish an informed view as to whether the circumstances of a particular case provide sufficient cause for the customer not to return income to their current balance date. The following paragraphs explain the relevant matters that will be considered by the Commissioner.

Compliance costs

15. Business customers may incur compliance costs in a number of ways, including general accounting, financial and reporting requirements. Compliance costs will be considered as a factor when a customer is able to show they will incur unreasonable or excessive costs as a consequence of having to return income to 31 March (or their current balance date). The Commissioner will consider normal compliance costs, excluding for instance those incurred by choice by customers through self-imposed internal planning or reporting requirements.

16. The Commissioner will also consider the impact of other statutory reporting requirements on customers' annual accounts and their tax obligation to return income.

Passive income

17. Passive income is a term used to describe income derived from investments or property that does not require direct physical exertion or the application of specialist skill by a customer (eg, the receipt of interest or dividends). In contrast, a business activity includes a profession, trade, manufacture, or undertaking carried on for a pecuniary profit.

18. Customers whose primary source of income is from passive investments will generally be required to return income to 31 March. Much of the information on earnings required to file a return is available from financial institutions on a periodic basis.

19. An exception to this general rule is when entities related to a customer are engaged in a business activity that has a non-standard balance date. This concession is to avoid additional compliance costs and disruption with preparing annual accounts when a customer derives passive income through the business activity of a related entity.
20. The following example shows how the passive income exception may arise.

> **Example: Passive income from a related entity**
>
> A family trust leases a farm to a family trading partnership. The family trust passively derives their primary source of income from lease payments made by the related family partnership, which has a non-standard balance date. In this case, the Commissioner will consent to the family trust adopting the non-standard balance date used by the partnership.

Income from a Foreign Investment Fund

21. A further exception applies to customers with an attributing interest in a Foreign Investment Fund ("FIF") that calculate their FIF income or loss using the attributable FIF income method. Section EX 69 of the ITA 2007 provides specific rules for changing an FIF balance date. The FIF requires the Commissioner's consent before a new balance date can be used.

Customers with wage/salary as well as business income

22. In situations where a customer has income from salary or wages as well as business income, the Commissioner may still consent to a non-standard balance date.

> **Example: Wage/salary as well as business income**
>
> A customer earns a salary as a teacher and also has a small orchard from which she derives business income. The customer wishes to adopt a non-standard balance date of 30 June. The Commissioner would agree to the change of balance date as it is an industry-approved balance date, despite the income from salary/wages. In this situation the customer will return their business income to 30 June, but will continue to return the income from her salary to 31 March.

Industry balance dates

23. Some businesses have a natural end to their income year, for example, the end of a growing season, the end of a traditionally busy trading period, or the time in the annual business cycle in which the majority of income and relevant costs can be brought to account.
24. Examples of businesses which have "natural" income years not ending on 31 March include farmers, or growers or harvesters of primary produce that are subject to seasonal climate conditions or the natural cycle of stock breeding. That may also extend to directly related service industries involved in, for instance, the harvesting, processing, packaging, and exporting of produce.
25. Market demands for manufactured goods, and the seasonal impacts on the growing or harvesting of produce, influence the trading patterns of many businesses. Customers impacted by seasonal constraints or demands on their businesses may find a 31 March balance date impractical when their attention is on those seasonal activities and the majority of their income is yet to be derived.
26. The natural end to a season for growers or retail manufacturers can be identified with the end of their production cycle when the last, or majority, of their produce is delivered to a processor or retail outlet. Once the harvest or peak business period is completed, a grower or manufacturer then prepares for the next annual busy season.
27. The Commissioner recognises a number of industry-specific non-standard balance dates (refer to Appendix A). These dates have been determined following representations to the Commissioner by the industries concerned. Customers within these industries may apply to the Commissioner for consent to adopt these approved industry balance dates. See further comment at [31] to [34] on how to apply.
28. Customers aligned to an industry that has a recognised non-standard balance date still have the option to seek an alternative non-standard balance date (or remain with 31 March) if the industry balance date does not suit their circumstances.
29. Where taxpayers want to adopt an alternative non-standard balance date, they are required to make a full application that will be decided on the merit of each individual case (see further comment at [35] and [36]).

Unit trusts, managed funds and "as agent" returns for non-resident insurers

30. Inland Revenue will consider requests for a non-standard balance date from the following entities:

(a) *The trustee of a unit trust that wishes to align its balance date with that of its manager*

A unit trust may choose to align its balance date with that of its manager. The manager is the entity with responsibility for the management of the unit trust and is appointed under the trust deed. Adoption of the manager's balance date is appropriate only if the manager has retained the responsibility for day-to-day administration of the unit trust.

(b) *The trustee of a group investment fund that wishes to align its balance date with that of its manager*

A group investment fund is administered and overseen by a manager. The fund may have a separate trustee, although there is no requirement that the trustee and manager be separate entities. Consent will only be granted to align the fund's balance date with that of the manager.

As with unit trusts, the concession applies only when the manager has retained the responsibility for day-to-day administration of the trust and for preparing the trust's accounts. When these functions have been contracted out to a third party, it is not appropriate to adopt the manager's balance date.

(c) *A superannuation fund that wishes to align its balance date with that of its trustee*

The trust deed under which a superannuation fund is established will appoint a trustee to supervise the fund. Consent will be given for a fund to align its balance date with that of the trustee, provided that the trustee's role has not been contracted out to a third party.

(d) *A superannuation fund administered by an employer for the benefit of its employees wishes to align its balance date with the balance date of the employer*

(e) *A managed fund that wants to align its tax balance date for financial reporting purposes*

A managed fund (including unit trusts, group investment funds and superannuation funds) may choose to align its balance date with that for financial reporting purposes if it can be demonstrated that the alignment of balance dates helps reduce the managed fund's tax risks. The purpose of this concession is to promote voluntary compliance and good tax practices. Inland Revenue expects the managed fund to set out the reasons for changing their balance dates. These reasons will be examined on a case-by-case basis.

However, the concession does not apply if:

(i) the reason for changing the balance date is to improve the managed fund's administration of human resources (eg, smoothing the workflows of their managers);

(ii) the managed fund cannot provide evidence of what the tax risks are and how the change of balance date helps to mitigate these risks;

(iii) the managed fund can identify some of its tax risks but the change of balance date is irrelevant to the mitigation of these risks.

(f) *A customer (who is a resident for taxation purposes) required to file an "as agent" return and wishes to align the balance date of that return with their own non-standard balance date*

A customer who insures with a non-resident insurer is required to return part of the premiums paid as income in a return known as an "as agent" return (s HD 16 of the ITA 2007). This income is returned "as agent" for the non-resident insurer.

Customers with an approved non-standard balance date for their own returns will be granted consent to align the balance dates of their "as agent" returns to this date.

How to make a request

31. Requests for the Commissioner's agreement to change a balance date can be made using myIR secure online services, or by telephone (0800 377 774), or by correspondence where:

(a) a customer who operates a business wants to adopt a recognised industry balance date (see further Appendix A); or

(b) a shareholder-employee wants the same non-standard balance date as a company to which their shareholding relates, where earnings from the company is their primary source of income; or

(c) a continuing estate wants to adopt a balance date that coincides with a deceased customer's date of death; or

(d) a subsidiary company wants to align to the balance date used by a parent company; or

(e) a non-resident customer wants to adopt a balance date applicable in their country of residence, when they perform a business activity in New Zealand, but have a centre of management outside New Zealand (this concession does not apply to customers who only earn passive investment income); or

(f) a previously tax-exempt entity wants to continue to use a balance date consistent with that used for financial reporting purposes.

32. These varied methods of election recognise that for these specific scenarios the criteria for adopting a non-standard balance date may be easily verified at the time of contact.

33. Requests for the Commissioner's agreement for the situations listed under [31] must contain the following details (as relevant):

(a) full name of the customer seeking the non-standard balance date;

(b) Inland Revenue number if already registered;

(c) the balance date sought;

(d) details of reasons for election to change the balance date;

(e) income year their new balance date is to apply from;

(f) name of tax agent.

34. Where a request is made to adopt a balance date in common with a related entity the nature of that relationship should be included as part of the request. Providing such information can help minimise any delay.

35. Other requests for a change to a balance date may be made via myIR secure online services or by correspondence, where:

(a) a customer wishes to adopt an alternative balance date to the 31 March, due to the specific circumstances of their business activity; or

(b) a customer's circumstances have changed significantly and a balance date previously agreed to is no longer appropriate; or

(c) a customer wishes to align balance dates for business entities with a close working relationship, where these entities share a common business/management accounting system or central administration structure; or

(d) a managed fund wishes to adopt the non-standard balance date of the fund manager or trustee and it can be demonstrated a parent–subsidiary-like relationship exists between parties; or

(e) entities deemed to be agents of non-resident insurers file "as agent" returns in terms of s HD 16 of the ITA 2007; or

(f) a franchise owner wants to adopt the balance date used by a master franchisor.

36. As requests for a change of balance date for the situations listed under [35] are potentially more complex requests, they should be made via myIR secure online services or by correspondence. These requests should include the following information (as relevant):

(a) full name of the customer seeking the balance date change;

(b) Inland Revenue number if already registered;

(c) The balance date sought;

(d) details of reasons for election to change the balance date;

(e) income year their new balance date is to apply from;

(f) name of tax agent;

(g) details of cash flows;

(h) details of stock patterns;

(i) details of any significant business transactions that will impact on their tax liability for the current financial year;

(j) other evidence to show that financial information prepared to the proposed balance date will be more appropriate to the entity;

(k) where businesses claim they have a close trading relationship and share a common accounting system or central administration structure, evidence to support this assertion.

Related matters

Retrospective elections

37. Requests to change a balance date should be made prior to the commencement of a new income year, so that customers can avoid additional compliance costs if the Commissioner does not approve the change of balance date.

38. In the past, the Commissioner's practice had been to defer the effective date for a change of balance date until the following income year. Going forward, the Commissioner, in limited circumstances, may agree to a retrospective change of a balance date change for a current income year where the request is received before the earlier of the return filing date under s 37(1) for the current balance date and that for the proposed balance date (excluding any extension of time arrangements for filing returns).

39. Retrospective agreement will be provided where customers can show that:

    (a) it is possible to file returns for all the income years;

    (b) the late election was not made for reasons of tax deferral or tax avoidance, or to take undue advantage of any tax incentive or concession;

    (c) any tax deferral occurring as a consequence of the proposed balance date change is insignificant (when compared to the customer's total tax liability).

Misleading information

40. When a request for a change of balance date is received, the Commissioner will consider the reasons and information provided in support of the request. The onus is on customers to make a full disclosure of the reasons for the change and to provide all relevant information to support their application.

41. However, the Commissioner is not bound by any agreement that was based on misleading or incomplete information.

Income tax transitional period returns

42. When the Commissioner agrees to a change of balance date, the customer will be advised of the effective date of the change and the period for transitional return which will be required (with the exception of new taxpayers who elect to use an alternative balance date upon registration or for their first return period). Further information on transitional return periods is given in Appendix B.

Provisional tax payments

43. Where a change of balance date is agreed to, until the new balance date is reached, the customer will still need to pay provisional tax on the instalment dates that applied before the change. Once the new balance date is reached the provisional tax instalment dates relating to the new balance date will apply. Further information on transitional return periods is given in Appendix B.

Effect for GST purposes of change of balance date

44. When a customer who is a liable to pay provisional tax and is GST registered (other than a GST ratio-method taxpayer) changes their balance date so that their GST taxable periods no longer align with the new balance date, they must change their GST taxable periods to align with the new balance date. Further information on alignment of GST taxable periods with a new balance date is given in Appendix B.

Notification of the Commissioner's consent

45. The Commissioner will generally respond to a request (by telephone, or myIR secure online services, or correspondence) in the same way in which the customer made their request. For complex situations, the Commissioner is likely to set out the transitional return period and consequential change details for a change of balance date in writing (via myIR secure online services or correspondence).

Reviewing a decision of the Commissioner

46. Section 138E(1)(e)(iv) provides that there is no statutory right of challenge where the Commissioner has made a decision to decline a balance date change request under section 38.

47. However, if a customer is concerned that their circumstances have not been given proper consideration they should raise their concern with the officer they have been dealing with and ask that the decision to reconsidered. If they are still not satisfied with the decision, they may ask to have the decision reviewed by the Office of the Ombudsman or a judicial review. It is strongly recommended that independent legal advice be obtained.

48. If a taxpayer is still not satisfied with the level of service they receive, they can obtain more information about the Inland Revenue's Complaints Management Service at **www.ird.govt.nz** (search keyword "complaints process") or phone 0800 274 138 (Monday to Friday between 8 am and 5 pm).

This Standard Practice Statement is signed on 11 April 2018

Rob Wells
Manager, Technical Standards, OCTC

Appendix A: Industry-specific non-standard balance dates

The Commissioner recognises a number of industry-specific balance dates. These dates have been determined following representations to the Commissioner by the industries concerned. Taxpayers in these industries, or closely aligned to them, may elect to adopt these approved industry balance dates (see comments at [20] to [26]), subject to the Commissioner's prior notified consent under s 38(3).

Apiarists		30 November or 31 December
Education/childcare related services		31 December
Farmers,	cattle	31 May
	dairy	31 May, or 30 June, or 31 July*
	sheep	30 June
Fishing industries		30 September
Horse breeders		31 July
Meat processing and export		31 August or 30 September
Orchardists, pip fruit		31 March or 30 June or 31 December
Kiwifruit		**31 January, or 28 February, or 31 March
Seed dressers		30 November
Tobacco growers		31 July

* Expanded to 30 June or 31 July to recognise regional variances within the dairy industry.

** Changed Dec 2010 to reflect improved growing techniques and early kiwifruit cultivars producing earlier crops – *Tax Information Bulletin* Vol 23, No1 (issued Feb 2011)

Note: When there is more than one recognised industry balance date for an activity, the Commissioner's consent will be required for any subsequent election to adopt an alternative industry balance date.

Appendix B: Consequential impact of a balance date change

A) Income tax transitional period returns

This appendix explains how the Commissioner applies the legislation concerning the transitional income tax returns required following the Commissioner's agreement to use an alternate balance date. It also states the Commissioner's practice on the effective date for a change of balance date.

Section 39 sets out the treatment for transitional year returns.

When the new balance date is earlier in the calendar year than the original balance date, the taxpayer's transitional year will run from the original balance date to the new balance date. (This will generally be a period of six months or more.)

When the new balance date is later in the calendar year than the original balance date, the taxpayer's transitional year will run from the original balance date to the new balance date in the succeeding year. (This will generally be a period of more than 12 months.)

Under s 39, when there is a change of balance date the taxpayer must file a transitional tax return. This return is for the income derived during the transitional period which begins on the day after the original balance date and ends on the new balance date.

It is the Commissioner's view that new business taxpayers who may elect to apply a non-standard balance date upon registration or their first return period, are not directly impacted by the transitional return provisions. Their first return will cover the period from commencement of business to their elected balance date, (instead of to 31 March).

Although the transition year provisions are not applied directly to new taxpayer situations, there may be occasions when consideration of a balance date election spans more than one return period by days or weeks due to the timing of a request and the Commissioner providing consent. When these situations occur, favourable consideration will be given to taxpayer requests to include the start-up income details for the initial start-up in the substantive return that follows.

Section 39 reads:

> **39(1)** If the Commissioner approves a change to a new balance date that is earlier in the year than the original balance date, the change is effected by the taxpayer having a transitional year of the period from the original balance date up to and including the new balance date in the next succeeding year.
>
> **39(2)** If the Commissioner approves a change to a new balance date that is later in the year than the original balance date, the change is effected by the taxpayer having a transitional year of the period from the original balance date up to and including the new balance date in the same year.
>
> **39(3)** If the change in balance date means that a taxpayer has 2 corresponding income years for the same tax year, the figures for both corresponding income years are aggregated when the taxpayer's net income or net loss is determined.
>
> **39(4)** For the purpose of giving effect to this section and section 38, the Commissioner may, for any corresponding income year, make any assessment that the Commissioner considers necessary.
>
> **39(5)** For the tax year corresponding to the income year or income years in which the change of balance date occurs, the basic tax rate for the purposes of the Income Tax Act 2007 and this Act is the rate that would apply if the person's taxable income for the tax year were calculated using a value for the person's net income, or net loss, for the tax year equal to the total of—
>
> (a) the amount that, if the person had no income or expenditure associated with each business activity affected by a change of balance date for the tax year, would be obtained by subtracting the person's annual total deduction for the tax year from the person's annual gross income for the tax year; and
>
> (b) for each business activity affected by a change of balance date for the tax year, the amount given by subsection (6) for the tax year and the business activity.
>
> **39(6)** The amount given by this subsection, for a tax year and a business activity affected by a change of balance date for the tax year, is calculated using the formula—
>
> unadjusted business net × year days ÷ income year days.
>
> **39(7)** In the formula,—
>
> (a) **unadjusted business net** is the amount that, if the person had no income or expenditure other than income and expenditure associated with the business activity, would be the difference between the person's annual gross income for the tax year and the person's annual total deduction for the tax year:
>
> (b) **year days** is—
>
> (i) 365, if subparagraph (ii) does not apply:
>
> (ii) 366, if the income year or income years corresponding to the tax year include a 29 February:
>
> (c) **income year days** is the total days in the income year or income years corresponding to the tax year.

Note: Section 39 uses the terms "earlier" and "later". These should not be confused with the terms "early balance date" and "late balance date". Section 39 refers to a balance date that is "earlier in the year than the original balance date" and a new balance date that is "later in the year than the original balance date". The "original balance date" may itself be a non-standard balance date.

Example 1: Early balance date

A 31 March balance date is to change to 31 January. The return for the 2017–18 income year will cover the period from 1 April 2017 to 31 January 2018 (a 10-month transitional year). The return for the 2018–19 income year will be from 1 February 2018 to 31 January 2019.

Example 2: Late balance date

A 31 March balance date is to change to 30 June. The return for the 2017–18 income year will cover the period 1 April 2017 to 30 June 2018 (a 15-month transitional year).

STANDARD PRACTICE STATEMENTS

Returns for less than six months or more than 18 months

Changes to balance dates will generally result in a transitional period of more than six months, but no longer than 18 months. However, in some circumstances returns are required for a period of less than six months or more than 18 months. Returns for a period longer than 18 months only occur when there is a change from an early balance date to a late balance date. Returns for a period shorter than six months only occur when there is a change from a late balance date to an early balance date.

Example 3: Change from a late balance date to an early balance date

In 2017 a customer changes from a balance date of 30 September to 30 November for the 2018 income year (transitional return year):

1/10/16 – 30/09/17:	2016–17 income year
1/10/17 – 30/11/17:	Two-month period within the 2017–18 income year (transitional return year)
1/12/17 – 30/11/18:	2018–19 income year.

In this case it is not possible to include the income derived during the two-month period in the 2017–18 income year with other income derived in the same income year, because there is no other income derived during the 2017–18 income year. The taxpayer must file a two-month transitional return for the 2018 income year.

Example 4

In 2016 a customer changes from a balance date of 30 November to 31 July for the 2017–18 income year (transitional return year):

1/12/15 – 30/11/16:	2016–17 income year
1/12/16 – 31/07/17:	Eight-month period within the 2016–17 income year (transitional return year)
1/08/17 – 31/07/18:	2017–18 income year.

The legislation requires the customer to add the income derived during the transitional period to other income derived in the same income year. Therefore, the customer must add the income derived in the eight-month period from 1 December 2016 to 31 July 2017 to the income derived in the period from 1 December 2015 to 30 November 2016 giving a return for a 20-month period for the 2017 income year.

B) GST and provisional tax consequences

Section 39B sets out the treatment for customers with provisional tax and GST liabilities, which may also require consideration when a customer elects to change a balance date.

Tax Information Bulletin Vol 18, No 5 (June 2006) comments on the GST consequences of changing a balance date for income tax purposes at page 73:

> When a taxpayer changes their balance date, until the new balance date is reached the taxpayer must continue to pay provisional tax on the instalment dates that applied before the change of balance date. Once the new balance date is reached the taxpayer pays provisional tax on the instalment dates relating to the new balance date.
>
> Instalments of provisional tax in this transitional year are due on the 28th of the months specified in Schedule [3], Part B and the final instalment is due on the 28th of the month following the final month in the transitional year or 15 January where November is the final month.
>
> The provisions relating to the calculation of provisional tax liability using the standard and estimation options are similar. However, the legislation introduces rules for the calculation of provisional tax in the transitional year for those taxpayers who use the GST ratio method. When a taxpayer changes their balance date and moves from a set of instalment dates in even-numbered months to a set of instalments in odd-numbered months or vice versa, there will be a one-month period when GST and provisional tax are due before they change to their new balance date. The taxpayer will determine the amount of provisional tax due for this period by applying the ratio to the one-month's GST taxable supplies.
>
> When a taxpayer (other than a GST ratio method taxpayer) changes their balance date and their GST taxable periods do not align with their new balance date, the taxpayer must change their GST taxable periods to align with the new balance date. This is achieved by truncating the last taxable period before the new balance date so that the taxable periods and income year end on the same date.

Sections 15B and 15D of the Goods and Services Tax Act 1985 refer to the alignment of GST return taxable periods with income tax balance dates and refer to a GST-registered person's obligation to ensure that their GST return periods are aligned to a changed income tax balance date.

Should a realignment of GST return taxable periods be required, realignment is to take effect in the income year when a new balance date is applied.

If a change in balance date results in a registered person's taxable periods not being aligned with their new income tax balance date, the Commissioner is required to make an adjustment to truncate the last GST return taxable period before a new income year/balance date is applied.

Similarly, a customer who is liable to make provisional tax payments must continue to pay provisional tax on the instalment dates that apply before the change of balance date has application to their income tax return filing obligations and the Commissioner has given consent. The provisional tax instalment dates change in the income year that a new balance date takes effect, which is either the transitional return period or a new business customer's first return period.

When consent to a balance date change occurs, Inland Revenue staff handling balance date change requests will alert customers to the impact of transitional return periods, GST return taxable period realignment and provisional tax payment instalment dates, and related timing of these change impacts (if applicable).

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.

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

Case	Commissioner of Inland Revenue v Patty Tzu Chou Lin [2018] NZCA 38
Decision date	8 March 2018
Act(s)	Income Tax Act 2007 Subparts BH and LK; Agreement between the Government of New Zealand and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (New Zealand/China DTA)
Keywords	Controlled Foreign Companies, CFC, Double tax agreement, Article 23 New Zealand/China DTA, tax sparing, tax credits, OECD Model, UN Model

Summary

The Court of Appeal was satisfied that the Commissioner of Inland Revenue ("the Commissioner") was correct in refusing to allow Patty Tzu Chou Lin ("Ms Lin") a further credit for New Zealand tax payable on her attributed Controlled Foreign Companies ("CFC") income for the tax totalling $588,135.91 that the CFCs had been spared from paying in China under Chinese domestic law.

Impact

The decision confirms that New Zealand residents will not be entitled to a credit against income tax liability in New Zealand for tax spared by China on income earned there by companies in which the resident has a relevant income interest.

Facts

Ms Lin is a New Zealand tax resident and her income is subject to New Zealand tax regardless of where it is sourced.

Between 2005 and 2009 (the tax years in dispute) Ms Lin had a 30 per cent interest in five companies which were resident in China. Each company was defined as a CFC for New Zealand tax purposes.

As a result, the income derived by four of the five Chinese companies was attributed to Ms Lin for New Zealand tax purposes under the CFC regime.

The Commissioner attributed to Ms Lin CFC income from the Chinese companies totalling $4,605,162.98. The New Zealand tax payable by Ms Lin on this income was about $1.796 million. The Commissioner allowed Ms Lin tax credits under New Zealand domestic law of $926,968.12. Her New Zealand tax liability on her attributed CFC income was offset by that amount for Chinese tax actually paid by the Chinese companies. The Commissioner assessed Ms Lin as liable to pay attributed tax of $869,000.

The Chinese companies were spared from paying tax totalling $588,135.91 under Chinese domestic law which would otherwise have been imposed on their incomes. The Commissioner refused to allow Ms Lin a further credit for New Zealand tax payable on her attributed CFC income for the Chinese tax spared.

Decision

The Court noted that subpart BH of the Income Tax Act 2007 ("the 2007 Act") provides for double tax agreements between New Zealand and foreign states. Further, that by s BH 1(4) a double tax agreement has effect in relation to income tax despite anything else provided in the 2007 Act and is effectively incorporated into New Zealand domestic law.

The starting point for the Court's analysis was the CFC regime. This regime was introduced to prevent New Zealand residents from deferring or avoiding New Zealand tax by accumulating income in non-resident companies.

Having discussed how the CFC regime operated, the Court then turned to the New Zealand/China DTA. The Court noted that the purpose of the New Zealand/China DTA is, like all of New Zealand's DTAs, to produce revenue reciprocity. That is, one country foregoes some of its income tax rights over source or residence taxation in return for the other country foregoing some of the same rights. The common economic purpose being to ensure that income is taxed only once.

The appeal centred on the proper construction of art 23 of the New Zealand/China DTA. The Commissioner's case was that the plain meaning and purpose of art 23 is to provide relief from juridical double taxation alone. Ms Lin's counsel argued by reference to various provisions of the OECD Model and its updated Commentaries that art 23 is directed to relieving against both juridical and economic double taxation.

The Court considered that the issue was best addressed by construing the text of art 23 as a sequential and related whole within its settled context.

The Court agreed with the Commissioner's submission that art 23(1) had the plain purpose of eliminating juridical double taxation in China by limiting the entitlement of a resident of that country to a credit on tax actually paid in New Zealand on income derived here. The Court noted that while there are linguistic differences between art 23(1) and its companion provision art 23(2)(a) they held that the necessary inference, in the absence of any contrary intention, is that both relieve against juridical double taxation, allowing only credits for taxes actually paid by a domestic resident in the foreign jurisdiction.

The Court agreed with the Commissioner's submission that in terms of art 23(2)(a) the "income" of the CFC was not "derived" by Ms Lin in China; and the tax paid or spared to the CFC was not payable, paid by or spared to Ms Lin. The Court found that there was no scope to import a proposition that the "income derived" refers to the deemed or attributed income of the CFC under New Zealand legislation.

The Court disagreed with the High Court's construction of art 23(3) that, when read in conjunction with art 23(2)(a), the phrase "payable … by a resident of New Zealand" includes tax deemed to have been paid or payable by the New Zealand resident on income or tax deemed to have been earned or paid by the New Zealand resident through the CFC regime. Instead the Court viewed 23(3) as confirming the focus of art 23(2)(a) as being on "tax payable in … China by a resident of New Zealand."

Ms Lin's counsel particularly relied on the phrase "in respect of" where it first appears in art 23(2)(a) and stated that it should be construed as requiring a connection between tax paid in China and tax payable in New Zealand. The Court disagreed and said that the phrase "in respect of" is synonymous with "on". The Court was satisfied that art 23(2)(a) requires the tax to have been paid by a New Zealand resident *on* income derived by him or her in China, not by a third party CFC.

The Court concluded that art 23(2)(a) relieves solely against juridical double taxation. Ms Lin's counsel's argument required the Court to disregard the legal nature of the relationship between Ms Lin and the CFCs. The fact that the ultimate source is income attributed to Ms Lin from the Chinese CFCs does not justify treating the two income streams, earned separately by the CFCs and Ms Lin, as one for revenue purposes, and ignoring the plain foundation of art 23(2)(a) on the source of "the income derived by a resident of New Zealand".

Effect of Self-Employment and Community Involvement on Decision to Bankrupt under s 37 of Insolvency Act 2006

Case	Commissioner of Inland Revenue v Stephens [2018] NZHC 519
Decision date	23 March 2018
Act(s)	Insolvency Act 2006 s 37; Tax Administration Act ss 6, 6A(3) and 176(1)
Keywords	Bankruptcy, discretion, public interest

Summary

The Judgment Debtor, Tainui Stephens ("Mr Stephens"), opposed the Commissioner of Inland Revenue's ("CIR") application for an order adjudicating him bankrupt. Mr Stephens relied on s 37 of the Insolvency Act 2006 ("the Act"), which provides a broad discretion for the High Court to decline to grant an order where it is just and equitable that the Court does not make an order, or where for any other reason an order should not be made. The Court held that the impact of an order of Mr Stephens' career as a self-employed film producer and writer was not sufficient to trigger the exercise of its discretion under s 37.

Impact

This case reaffirms the large body of case law which provides a high threshold for the exercise of the s 37 discretion, especially in tax arrears cases where there is a significant public interest factor in granting an order.

Facts

Mr Stephens is a self-employed contract worker in the Māori film industry. He had failed to pay income tax for the years 2007 to 2017. He also had some GST debt. The CIR's application for an order adjudicating Mr Stephens bankrupt was based on a judgment for $551,027.63 of tax arrears. At the date of hearing, Mr Stephens was still not keeping current with his tax affairs. Mr Stephens was also the sole director of a company, Pito One Productions Limited, which was put into liquidation by the CIR in February 2017 with tax debts of $232,793.47.

Decision

The Court agreed with the CIR that the three particular elements of the case relevant to s 37 were:

a. the interests of Mr Stephens himself – in particular, his ability to support himself, his age, the impact of the stigma of bankruptcy on his work and community activities;

b. the possible presence of assets, and the potential for matters requiring the investigation of the Official Assignee; and

c. the public interest.

Mr Stephens argued that the High Court should exercise its general discretion under s 37 of the Act to decline the CIR's application for an order. Mr Stephens' main submission was that his work in the film industry and as a board member and trustee of various industry and community organisations would be impeded by an order. He stated that his work was of considerable public interest and that there were few who would be able to fill his place as a contributor to the Māori screen industry.

The CIR submitted that Mr Stephens would be able to apply to the Official Assignee or the Court for leave to continue work in a self-employed capacity, and also that his ceasing to be self-employed would not justify the exercise of discretion under s 37. The CIR further submitted that Mr Stephens had disregarded taxation for a long time and therefore there was a considerable public interest in granting an order. It was also argued that the long history of non-compliance also displaced considerations regarding the effect of bankruptcy on Mr Stephen's community participation.

The CIR also showed that there was evidence of properties owned by Mr Stephens and his wife, which were matters that should be investigated by the Official Assignee. The CIR further relied on the public interest in collecting revenue and the Commissioner's statutory duty to maximise recovery and protect the integrity of the tax system under ss 6A(3), 6 and 176(1) of the Tax Administration Act.

The Court acknowledged that Mr Stephens' contributions to film production and community involvement were likely to be reduced if an order were made. The Court stated that the question was whether the public interest in maintaining the integrity of the tax system outweighed those considerations. The Court decided that it did. The Court stated that Mr Stephens would be able to work with the Official Assignee and his supporters in the film industry to use his talents notwithstanding his bankruptcy. The Court further held that Mr Stephens had shown disregard or disrespect for tax obligations and considerations of public morality also weighed in favour of an order.

Lawyer who lent money to clients denied deduction for bad debts

Case	XXX v Commissioner of Inland Revenue [2018] NZTRA 03
Decision date	29 March 2018
Act(s)	Tax Administration Act 1994 ss 3, 15B, 138G, 141A, 141FB, 141I and 149; Income Tax Act 2007 ss BD 4, DB 31, DA 1 and EW 29; Insolvency Act 2006 s 304.
Keywords	Bad debt, deduction, reasonable care, commerciality, lending business, business test, money lending

Summary

The disputant is a solicitor in sole practice who claimed two deductions for bad debts in respect of loans he had extended to clients of his legal practice. The Taxation Review Authority ("the Authority") found that the deductions were not allowed because the disputant had not shown that he had written the debts off as bad in the income year in which he had claimed them, nor were the debtors released from their obligations to pay by operation of law in that income year. Furthermore, the Authority found that the disputant had not satisfied the requirement of carrying on a business which included dealing in or holding financial arrangements. A shortfall penalty was imposed for not taking reasonable care under s 141A of the Tax Administration Act 1994 ("the TAA").

Impact

The decision provides the first authority in respect of the application of subsection DB 31(1)(a)(ii) of the Income Tax Act 2007 ("the ITA") which was inserted in the legislation on 27 February 2014 with retrospective effect to debts that go bad on or after 1 April 2008.

The position taken by the Authority in respect of the existence of the public ruling and the imposition of shortfall penalties provides a nuance of the legal position as taken in *Easy Park Limited v Commissioner of Inland Revenue* [2017] NZHC 1893 ("*Easy Park*"). In *Easy Park* Ellis J reasoned that the existence of a public ruling suggested the subject matter was difficult and controversial and went on to find that the tax position taken by the plaintiff was not unacceptable for the purpose of imposing shortfall penalties under s 141B of the TAA. The Authority in the present case also considered that the public ruling signified a complexity of the law, but found that a reasonable person in the disputant's circumstances ought to have sought legal or tax advice before taking the tax positions when confronted with complex and technical legislation. Shortfall penalties were therefore found to have been properly imposed for failing to take reasonable care under s 141A of the TAA.

The Authority otherwise applies settled legal principles (including the business test laid down in *Grieve v Commissioner of Inland Revenue* (1984) 6 NZTC 61,682) in considering the application of s DB 31 of the ITA and whether the disputant could avail himself of any of the listed exceptions to the general rule that deductions for bad debts are not allowed.

Facts

The disputant, a barrister and solicitor in sole practice, operated the 'Benevolence on the Conscience Loan Fund' ("the Fund") from which he extended loans to clients of his legal practice. The disputant described the Fund as adjunct to and part and parcel of his legal practice. His money lending services were extended only to longstanding clients who met his criteria of being people of good standing who could benefit from his assistance and where the need for assistance was related to a matter arising in the course of the disputant acting for the client.

In return, the clients had to agree to treat the disputant equitably. On this basis, the disputant hoped that the clients would pay him a bonus as well as interest on the lending. The disputant explained the benevolence part of the lending was that if clients could not pay it would be against his conscience to bankrupt them.

In his 2011 income tax return the disputant claimed deductions in respect of two loans of $50,000 and $300,000 which he had written off as bad debts.

The first loan was recorded in a basic loan agreement dated 12 July 2006, the terms of which provided that the borrower authorised the disputant to pay the net loan advance of $44,000 to the bank account held in the name of a company ("XY Limited") and $4,000 to "Mr C". The loan provided that it was to be a 'short term of loan: repayable on demand with interest at 10% on repayment'. The loan was unsecured.

The second loan was made by the disputant to "Mr T" and was recorded in a loan agreement in similar form dated 20 December 2006. This loan was also unsecured and described as being short term: "Repayable on demand with fair interest to you [the disputant] on repayment".

The disputant also claimed to have made at least three further loans of $200,000, $1,300,000 and $595,000 from the Fund since its inception in 2005. A previous loan of $20,000 was made in 1998. A loan agreement detailed that this loan was secured against a motor vehicle, interest of 22.4% per annum, default rate of 25% per annum. The borrower defaulted and the disputant had issued proceedings. The disputant explained he had not written off this debt as bad in his accounts as the borrower had been an associate and not a client of the firm.

Decision

The Authority first noted that the general rule is that deductions are not available for bad debts, subject to certain exceptions set out in s DB 31 of the ITA. Her Honour then went on to consider whether those exceptions applied.

Loans not physically written off as bad in the income year

Her Honour noted that the issue for determination is whether the debt has in fact been written off as bad in whatever books of account or accounting procedures are kept by the taxpayer. The disputant's evidence was that he operated a single-entry accounting system based on excel spreadsheets. He claimed that his legal executive had noted the write-offs in the profit and loss spreadsheet at the time the disputant became aware of Mr T's bankruptcy and when Mr C's company had been struck off the Companies Register.

The investigator gave evidence that in his experience profit and loss accounts were usually prepared after the end of the financial year as it was then that all the final figures were available. The investigator also gave evidence that he had checked the metadata of the profit and loss excel spreadsheet and noted that the document was created on 20 September 2011 (i.e. in the 2012 income year).

Her Honour noted that the legal executive had not been called to give evidence and found the disputant's evidence as to the steps taken by her to be unreliable. Accordingly her Honour found the debts had not been physically written off during the 2011 income year so as to satisfy the requirements in s DB 31(1)(a)(i) of the ITA.

Loans not released by operation of law

The Authority first found that the $50,000 loan had been extended to Mr C as an individual as opposed to XY Limited, as evidenced from the loan agreement which used personal pronoun throughout. As such it was the Insolvency Act 2006 ("the IA") as opposed to the Companies Act 1993 which contained the operative provisions which could release a loan by law. Section 304(1) of the IA provides that a person is released from their debts upon discharge from bankruptcy. As Mr C had never been adjudicated bankrupt and Mr T was only discharged from bankruptcy in 2013, the requirements in s DB 31(1)(a)(ii) of the ITA in respect of the debts being released by operation of law had not been met.

Disputant did not carry on a business which included holding financial arrangements

The Authority held that the disputant had not carried on a business which included holding financial arrangements. While her Honour accepted that the disputant had a profit making intention when extending the loans the disputant had committed very little time or effort on the operation of the Fund and the lending activities of the Fund were not carried out on anything like a commercial basis. The disputant had not required periodic payments of either interest or principal and the disputant had not taken any steps to recover any of the outstanding balances and did not take security for the loans. The disputant's evidence was that he had forgotten about the loan to Mr C until he was approached by Mr C for a second loan in 2009. Furthermore, the disputant had not advertised his moneylending services and had in fact required the confidentiality from his clients in respect of his lending to them.

Her Honour characterised the lending activity as that of a private individual using his capital funds to make loans to assist clients in financial difficulty who also meet his lending criteria. Accordingly, the requirements under s DB 31(3) had also not been met.

Deduction not allowed under general permission

The disputant argued that if a deduction was not available under s DB 31 of the ITA then a deduction should be allowed under the general permission. The Authority noted that s DB 31(6) set out the relationship between s DB 31 and subpart DA and found that as s DB 31(3) overrides the general permission it was not necessary to consider whether a deduction is available under the general permission once a determination is reached under s DB 31(3).

Shortfall penalties properly imposed

The Authority found that shortfall penalties for failing to take reasonable care pursuant to s 141A of the TAA had been properly imposed. The disputant had failed to act with the degree of care expected of a taxpayer in his position in not satisfying the obligations placed on taxpayers under s 15B of the TAA. The Authority further found that the disputant, when faced with complex and technical legislation, should have sought advice from a tax advisor before claiming sizable deductions which would necessarily result in a tax shortfall if the disputant was wrong in his application of the law.

GENERAL ARTICLES

2018 Square metre rate

For the purposes of section DB 18AA(5) of the Income Tax Act 2007, the Commissioner advises that the square metre rate for the 2017–2018 income year is $41.10 per square metre.

Notes to the 2018 square metre rate

Section DB 18AA(5) of the Income Tax Act 2007 requires that the *Commissioner must from time to time set and publish square metre rates*.

In *Tax Information Bulletin* Vol 29 No. 4 (May 2017) the Commissioner advised that this square metre rate will be:

- set by Inland Revenue, based on the average cost of utilities per square metre of housing, but excluding mortgage interest and rates or rent; and
- updated each year.

Section DB 18AA received Royal assent on 21 February 2017, with effect from the 2017–2018 and later income years.

Using information obtained from Statistics New Zealand, the Commissioner has calculated the average annual cost of utilities for the average sized New Zealand household (gas/electricity, telephone/mobile/internet services, and house/contents insurance) and divided this sum by the average square metre size of a New Zealand house[1].

Tax Information Bulletin Vol 29 No. 4 (May 2017)[2] provides further information regarding the use of the square metre rate. A copy of this *Tax Information Bulletin* may be found on the department's website **www.ird.govt.nz** (search term: May 2017 TIB).

[1] from information available from Quotable Value Limited

[2] At [73]

REGULAR CONTRIBUTORS TO THE TIB

Office of the Chief Tax Counsel

The Office of the Chief Tax Counsel (OCTC) produces a number of statements and rulings, such as interpretation statements, binding public rulings and determinations, aimed at explaining how tax law affects taxpayers and their agents. The OCTC also contributes to the "Questions we've been asked" and "Your opportunity to comment" sections where taxpayers and their agents can comment on proposed statements and rulings.

Legal and Technical Services

Legal and Technical Services contribute the standard practice statements which describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical operational issues arising out of the administration of the Inland Revenue Acts. They also produce determinations on standard costs and amortisation or depreciation rates for fixed life property used to produce income, as well as other statements on operational practice related to topical tax matters.

Legal and Technical Services also contribute to the "Your opportunity to comment" section.

Policy and Strategy

Policy advises the Government on all aspects of tax policy and on social policy measures that interact with the tax system. They contribute information about new legislation and policy issues as well as Orders in Council.

Litigation Management

Litigation Management manages all disputed tax litigation and associated challenges to Inland Revenue's investigative and assessment process including declaratory judgment and judicial review litigation. They contribute the legal decisions and case notes on recent tax decisions made by the Taxation Review Authority and the courts.

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