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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.

IN SUMMARY

Binding rulings

BR Pub 18/07: Income tax and goods and services tax – writing off debts as bad 3

This public ruling is an update and re-issue of BR Pub 05/01 *Bad Debts – Writing off debts as bad for GST and income tax purposes*. Although the existing ruling was issued for an indefinite period it had become outdated. The new item does not change the Commissioner's position on the tests to apply in deciding whether or not a debt is "bad", and what actions are sufficient to "write-off" a bad debt. The item only considers the questions of when a debt becomes "bad" and when the bad debt will have been "written off". It does not consider any of the other legislative requirements relating to deductibility of bad debts.

Notice of withdrawal of a public ruling 18

BR Pub 05/01 *Bad debts - writing off debts as bad for GST and income tax purposes* has been withdrawn because it has become outdated and does not reflect the increased use by taxpayers of computer-based accounting software. A new replacement public ruling, BR Pub 18/07 *Income Tax and Goods and Services Tax – Writing off debts as bad* is published with effect from 1 September 2018.

Interpretation statements

IS 18/03: Income tax – attribution rule for income from personal services 19

This Interpretation Statement concerns the attribution rule for income from personal services in ss GB 27 to GB 29 and expands on "Attribution of Income" *Tax Information Bulletin* Vol 12, No 12 (December 2000): 49. The income attribution rule only applies where various threshold tests are met and no exemptions apply. The Interpretation Statement provides guidance on the application of each of those threshold tests and exemptions, to assist readers in determining **whether** the income attribution rule applies to their situation. It does not provide guidance on how to calculate the amount to be attributed.

Standard practice statements

SPS 18/04: Options for relief from tax debt 37

This standard practice statement sets out the Commissioner's practice when considering the options for removing or deferring the obligation to pay tax, interest and/or penalties under the Tax Administration Act 1994. The options available to the Commissioner are to write off amounts, enter into an instalment arrangement, remit amounts, or a combination of these options.

Question we've been asked

QB 18/14: GST treatment of fees that suppliers charge customers for using a credit or debit card 58

This item considers the GST treatment of credit or debit card fees charged by suppliers to customers. These are fees charged by suppliers to recover the cost of providing a card processing facility. It considers the GST treatment where the supplier provides the payment facility directly to the customer; the supplier has arranged for an agent to provide the payment facility to the customer on the supplier's behalf; the supplier contracts with a third party to provide a payment facility to the customer. The item concludes that in all these cases, the fee will form part of the consideration for the goods and services being supplied and will have the same GST treatment as those goods or services.

Legislation and determinations

Special Determination S60: Spreading of income and expenditure under deferred payment arrangement 67

This determination applies to the applicants in relation to a deferred payment arrangement. Under the arrangement, a company assigned its rights to future cashflows to the applicants, in partial satisfaction of existing debts owed by the company to the applicants.

IN SUMMARY (continued)

Legal decisions - case notes

The Authority confirmed the assumption that all matters at issue are to be determined in one trial because that would normally be the most expeditious and efficient manner for dealing with a proceeding 69

This is an interlocutory application by the disputant for an order to have two questions decided in advance of the substantive trial. The application arises by the disputant challenging the Commissioner of Inland Revenue's assessments of income tax and GST on a number of grounds. The Authority held that the disputant did not discharge the burden to show that it is appropriate for either question to be heard in a separate trial.

High Court confirms that judicial review is discretionary and it is inappropriate for the Court to exercise its discretion to grant relief where it could serve no purpose or have practical effect 70

Brian Cyril Rowell ("Mr Rowell") judicially reviewed Zohrab's J decision to decline to recuse himself from hearing Mr Rowell's criminal charges. The basis for the judicial review was that Zohrab J showed bias in favour of the Prosecutor against Mr Rowell when he "provided a privately-distributed minute" to the prosecutor to use in New Zealand Law Society complaint proceedings. The Attorney-General opposed the application on the basis that Mr Rowell did not establish actual or apparent bias and that the judicial review was moot. There would be no practical effect of granting relief in this case as the charges against Mr Rowell have been transferred to the Wellington District Court and Zohrab J will not preside over any further proceedings involving Mr Rowell.

The Court found for the Attorney-General and the judicial review application was dismissed.

Court of Appeal confirms a lease surrender payment is a revenue receipt in the hands of the landlord 72

In the High Court, Ellis J concluded that the lease surrender payment received by Easy Park Limited ("Easy Park") was revenue and not a capital receipt in Easy Park's hands upholding the Commissioner of Inland Revenue's ("the Commissioner") classification of the lease surrender payment as taxable income. Easy Park appealed to the Court of Appeal.

The Court of Appeal agreed with the Commissioner and Ellis J in holding that the lease surrender payment in the hands of Easy Park was revenue and therefore taxable income. The appeal was dismissed.

High Court confirms amounts dealt with on property consultant's behalf attributable as income 73

Ethnik Krasniqi ("Mr Krasniqi") had not filed any returns for the 2005 to 2011 income years. The Commissioner of Inland Revenue ("the Commissioner") conducted an investigation which revealed Mr Krasniqi had undertaken consultancy work in New Zealand during this period. Substantial payments had been made from entities which Mr Krasniqi had worked for to his family members and third parties in Australia, where Mr Krasniqi's family was based. Mr Krasniqi also had access to an eftpos card connected to one of these entities and he used that card to cover personal expenses. The investigation also revealed Mr Krasniqi was the primary beneficiary of a family trust. The Commissioner issued default assessments in respect of payments she considered had been received by Mr Krasniqi or paid or dealt with on Mr Krasniqi's behalf or in his interest. The Taxation Review Authority upheld the majority of the Commissioner's assessments. Mr Krasniqi appealed the High Court and the Commissioner cross-appealed. The matter was heard before Wylie J in the High Court. His Honour dismissed both Mr Krasniqi's appeal and the Commissioner's crossappeal.

Forgiveness of debt held to be a "monetary" gift 75

Nancy Lois Roberts ("Mrs Roberts") challenged a decision of the Commissioner of Inland Revenue ("the Commissioner") disallowing charitable tax credits for gifts she made to the Oasis Charitable Trust ("the Trust"). At issue was the meaning of "a monetary gift of $5 or more that is paid…" under s LD 3(1)(a) of the Income Tax Act 2007 ("the Act") and whether Mrs Roberts' forgiveness of debt of the Trust constituted "a monetary gift". The Commissioner argued that forgiveness of a debt is not a charitable gift within the meaning of ss LD 1 and LD 3 of the Act, because "monetary" means the payment must be made in cash form only. The Court found in favour of Mrs Roberts.

Application for leave to appeal to the Supreme Court 77

Garry Albert Muir sought leave from the Supreme Court to appeal a decision a decision of Associate Judge Bell in which he entered summary judgment in favour of the Commissioner of Inland Revenue ("the Commissioner") against the applicant for unpaid taxes, interest and penalties for the 1997–2010 tax years. At issue was whether previous leave and revocation decisions of the Court determined the challenges that were then before the Court.

The Court found in favour of the Commissioner and did not grant leave.

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**

Public Ruling BR Pub 18/07: Income Tax and Goods and Services Tax - writing off debts as bad

This is an update and reissue of BR Pub 05/01. For more information about earlier publications of this Public Ruling see the Commentary to this Ruling.

This is a public ruling made under s 91D of the Tax Administration Act 1994.

Taxation laws

All legislative references to the ITA are to the Income Tax Act 2007 and all references to the GST Act are to the Goods and Services Tax Act 1985, unless otherwise stated.

This Ruling applies in respect of s DB 31(1)(a) of the ITA and s 26(1) of the GST Act.

The Arrangement to which this Ruling applies

The Arrangement is the writing-off of a debt (or part of a debt) as a bad debt, for income tax and/or GST purposes, in the following circumstances:

- An existing debt is owing to the taxpayer; and
- the debt has been adjudged as "bad" by a reasonably prudent commercial person who has concluded that there is no reasonable likelihood that the debt will be paid in whole or in part by the debtor or by anyone else (either on behalf of the debtor or otherwise); and
- the bad debt has been "written off" (in the income year or GST taxable period for which a deduction is claimed), in accordance with the accounting and record-keeping systems maintained by the taxpayer, in one of the following ways:
  - in the case of a taxpayer who maintains a computer-based accounting software system, an authorised person has made the appropriate entry in that system recording the debt as written off; or
  - in the case of a company taxpayer (other than one set out above), an executive or other responsible officer of the company with the authority to do so, has made the appropriate bookkeeping entries in the company's account books recording the debt as written off; or
  - in the case of a taxpayer (other than a company) who maintains double-entry accounts, an authorised person has made the appropriate bookkeeping entries in the business's account books recording the debt as written off; or
  - in the case of a taxpayer who is an unincorporated sole trader or small, unincorporated business taxpayer who does not maintain double-entry accounts, the taxpayer has made a note in their bookkeeping records setting out the amount owed by the bad debtor, stating that the debt has been written off, and recording the date of the writing off.

For the avoidance of doubt, the Arrangement does not include arrangements where subpart BG of the ITA and/or s 76 of the GST Act applies to void the arrangement.

How the taxation laws apply to the Arrangement

The taxation laws apply to the Arrangement as follows:

- The requirements of s DB 31(1)(a)(i) of the ITA will be satisfied and a deduction will be permitted for the amount of the bad debt that has been written off, provided that all the other requirements of s DB 31 are met.
- The requirements of s 26(1)(c) of the GST Act will be satisfied and a deduction will be permitted for the amount of the bad debt that has been written off, provided that all the other requirements of s 26 are met.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 1 September 2018.

This Ruling is signed by me on 29 August 2018.

Fiona Wellgreen
Senior Tax Counsel, Taxpayer Rulings

Commentary on Public Ruling BR Pub 18/07

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 18/07 (the Ruling).

Legislative references are to the Income Tax Act 2007 (ITA) and the Goods and Services Tax Act 1985 (GST Act) unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

Summary

1. The ITA and the GST Act allow taxpayers and/or registered persons a deduction for bad debts if certain criteria are met. Criteria common to both Acts are the requirements that the debt must be both bad and written off. There are other circumstances when a bad debt deduction can be claimed and other requirements that must be satisfied before a bad debt deduction will be allowed. This Ruling only considers the questions of when a debt becomes "bad" and when the bad debt will have been "written off". It does not consider any of the other legislative requirements relating to deductibility of bad debts such as the application of the capital limitation.
2. These issues were previously the subject of Public Ruling BR Pub 05/01. BR Pub 05/01 is replaced by this Ruling from 1 September 2018. BR Pub 05/01 concluded that a debt (or part of a debt) must be both bad and written off before any person can claim an income tax deduction or a deduction from GST output tax (assuming that other legislative requirements in the ITA and GST Act were also satisfied). This Ruling updates the earlier ruling but does not change the Commissioner's position.

Application of the legislation

3. Section DB 31(1)(a) of the ITA provides:

   DB 31 Bad debts

   No deduction (with exception)

   (1) A person is denied a deduction in an income year for a bad debt, except to the extent to which—

   (a) the debt is a debt—

   (i) written off as bad in the income year:

   (ii) for which the debtor is released from making all remaining payments under the Insolvency Act 2006 excluding Part 5, subparts 1 and 2 of that Act, or under the Companies Act 1993, or under the laws of a country or territory other than New Zealand, and the person is required to calculate a base price adjustment by section EW 29 (When calculation of base price adjustment required) for the debt for the income year:

   (iii) for which the debtor is a company that is released from making all remaining payments by a deed or agreement of composition, and the person is required to calculate a base price adjustment by section EW 29 for the debt for the income year; and

   …

4. Section 26(1) of the GST Act provides:

   26 Bad debts

   (1) Where a registered person—

   (a) has made a taxable supply for consideration in money; and

   (b) has furnished a return in relation to the taxable period during which the output tax on the supply was attributable and has properly accounted for the output tax on that supply as required under this Act; and

   (c) has written off as a bad debt the whole or part of the consideration not paid to that person,—

   that registered person shall make a deduction under section 20(3) of that portion of the amount of tax charged in relation to that supply as the amount written off as a bad debt bears to the total consideration for the supply:

   provided that where goods are supplied under a hire purchase agreement, the registered person shall only make a deduction under section 20(3) of the tax fraction (being the tax fraction applicable at the time that the hire purchase agreement was entered into) of that portion of the amount written off as a bad debt as the cash price bears to the total amount payable under the hire purchase agreement:

5. Each of s DB 31 of the ITA and s 26 of the GST Act requires that:
   - there must be a "bad debt"; and
   - the bad debt must have been "written off" (unless one of the circumstances described in s DB 31(1)(a)(ii) or (iii) of the ITA applies).

6. This commentary will discuss firstly the tests to apply in deciding whether or not a debt is "bad", and secondly what actions are sufficient to "write off" a bad debt. As stated above, we are not considering any of the other legislative requirements relating to deductibility of bad debts. The tests for whether or not a debt is "bad" and what is sufficient "writing off" of a bad debt, apply whether the debt is subject to the financial arrangements rules or not.

First requirement – debt must be "bad"

7. Whether a debt is bad depends on an objective, factual consideration of all the relevant circumstances of each case. When determining whether a debt is bad, the relevant time of inquiry is the time when the decision is made to write off the debt (*Case 45/93* 93 ATC 486, 27 ATR 1022).
8. A debt must be bad before it can be written off for the purposes of s DB 31 of the ITA and s 26 of the GST Act. A debt becomes a bad debt when a reasonably prudent commercial person would conclude that there is no reasonable likelihood that the debt will be paid in whole or in part by the debtor or by anyone else (either on behalf of the debtor or otherwise). The term "commercial person" refers to people who are concerned with or engaged in commerce or business and would include people who have professional knowledge of commerce such as directors of a company, a loans manager of a bank, accountants, a business consultant, and lawyers with business experience. The onus of proof is on the taxpayer. The standard to which the test must be proved is on the balance of probabilities: see *Budget Rent A Car Ltd v CIR* (*Budget Rent-A-Car*) (1995) 17 NZTC 12,263, at page 12,269; *Case N69* (1991) 13 NZTC 3,541, at page 3,548; *Graham v CIR, Edwards Graham Ltd & Edwards v CIR* (1995) 17 NZTC 12,107, at page 12,111; *Case T27* (1997) 18 NZTC 8,188, at page 8,194; *Case W3* (2003) 21 NZTC 11,014 at page 11,029.
9. To determine whether a debt is bad, there must be sufficient information to enable a reasonably prudent commercial person to form the view that there is no reasonable likelihood that the debt will be paid. This requires a bona fide assessment based on sound commercial considerations that the debt is bad. Payment of the debt must be more than merely doubtful. For example, a debt will not be accepted as bad merely because a certain set period of time for payment (eg, 90 days or 180 days) has elapsed with no payment or contact having been made by the debtor. A debt is not bad if there is still a real and continuing dispute about payment of the debt (*Case 45/93*). However, a debtor does not need to be insolvent for a debt to be bad (*Case N69*).

Factors to consider whether a debt is bad

10. Determining whether a debt is bad is a question of fact and will depend on the circumstances surrounding any particular case. However, the following factors may be relevant when considering whether a debt is bad (although no one factor is decisive):
    - The length of time a debt is outstanding – the longer a debt is outstanding the more likely it is that a reasonably prudent commercial person would consider the debt to be bad. This will of necessity vary depending on the amount of debt outstanding and the taxpayer's credit arrangements (eg, 90, 120 or 150 days overdue). However, a debt will not be considered bad merely because a set period of time for payment has elapsed with no payment or contact having been made by the debtor. Similarly, a debt may have only been outstanding for a short period and still be regarded as bad where other evidence exists that the debt will not be collected.
    - The efforts that a creditor has taken to collect a debt – the greater the extent to which a person has tried (unsuccessfully) to collect a debt, the more likely it is that a reasonably prudent commercial person would consider the debt to be bad.
    - Other information obtained by a creditor – a creditor may have obtained particular information about a debtor, for example through business or personal networks, of the kind that would lead a reasonably prudent commercial person to conclude that a debt is bad. For example, a creditor may know that the debtor is in financial difficulties and has defaulted on debts owed to other creditors.
    - The debtor has died leaving no, or insufficient, assets out of which the debt may be satisfied.
        - The debtor cannot be traced – the creditor has been unable to ascertain the existence of, or whereabouts of, any assets against which action could be taken.
        - Where the debt has become statute barred and the debtor is relying on this defence (or it is reasonable to assume that the debtor will do so) for non-payment.
        - If the debtor is a company in liquidation or receivership reports from the liquidator or receiver indicate there are insufficient funds to pay the whole debt, or the part claimed as a bad debt.

Taxpayer's information about the debt

11. A debt becomes a bad debt when a reasonably prudent commercial person concludes that there is no reasonable likelihood that the debt will be paid. In those circumstances a taxpayer's considered opinion will suffice so long as the view they have reached is the view that a reasonably prudent commercial person would reach.
12. However, the Commissioner also recognises that taxpayers have a financial interest in treating a debt as bad. Writing off a debt as bad may entitle a taxpayer to:
    - a deduction in calculating income for income tax purposes, worth up to 33% of the debt, depending on the taxpayer's marginal income tax rate; and/or
    - a GST deduction from output tax of the tax fraction of the debt.
13. Therefore, in the course of tax audits or other enquiries, the Commissioner may inquire into the taxpayer's decision to treat a debt as bad. In a dispute, it is up to the taxpayer to prove that, on the balance of probabilities, the debt was bad. Therefore, it is recommended that taxpayers document and retain relevant evidence to show that the decision to treat the debt as bad was a reasonable commercial decision. Documentation may include noting down the relevant information that gave rise to the decision that the debt was bad, and copies of any correspondence kept relating to the debt.
14. The amount of information required to decide whether a debt is bad will depend on the particular circumstances of each case. If the sum involved is small, a reasonably prudent commercial person is likely to make limited enquiries and take limited recovery action. Particular knowledge or information obtained by a taxpayer may also reduce the need for enquiry. However, the test is always whether the taxpayer has sufficient information to conclude, as any reasonably prudent commercial person would, that there is no reasonable likelihood that the debt will be paid, even if further or any recovery actions were to be taken.

Recovery steps taken

15. In most cases, before claiming a deduction for a bad debt, a creditor will have taken legal steps to recover the debt. It is through taking recovery action that most creditors will form an opinion that a debt is bad. However, recovery action does not need to be taken before deciding that a debt is bad. While recovery action is being taken, a debt can only be considered bad to the extent that a reasonably prudent commercial person would consider that there is no reasonable likelihood that the debt will be paid.
16. To establish that there is no reasonable likelihood that the debt will be paid, a reasonably prudent commercial person would, in most situations, take steps to recover the debt instead of simply writing it off. This may include a range of actions including legal proceedings. The appropriate steps undertaken will vary according to the size of the debt and the resources available to the creditor to pursue the debt. A creditor might not take any steps to recover the debt where the information suggests there is no hope of payment.
17. The steps taken to recover the debt would generally include one or more of the following:
    - issuing reminder notices;
    - attempting to make contact by telephone, mail, or email;
    - allowing a reasonable period of time to elapse since the original due date for payment of the debt – this will vary depending on the amount of the debt outstanding and the taxpayer's credit arrangements;
    - serving a formal demand notice;
    - commencing legal proceedings for debt recovery;
    - judgment being entered against the debtor;
    - executing proceedings to enforce judgment;
    - ceasing calculation and charging of interest and closing the account (a tracing file may be kept open, also, in the case of a partial write-off, the account may remain open);
    - valuation of any security held against the debt;
    - sale of any seized or repossessed assets.
18. While the above factors are indicative of the circumstances in which a debt may be considered bad, ultimately the question is one of fact and will depend on all the circumstances surrounding the transactions.

19. In some instances, taking recovery action may carry with it the reasonable expectation of recovery of some part of the amount involved. However, this will not always be the case. The decision to take recovery action and the extent of that action will depend on the circumstances surrounding any particular case. In some cases, the creditor may take no or only limited recovery action because enough information is held to form a reasonable view that the debt is bad. The amount of information needed will depend on the circumstances.
20. Conversely recovery action may be taken even when the creditor believes there is no reasonable likelihood that the debt will be recovered and has formed a reasonable view that the debt is bad. This may be the case, for example, when the creditor has a policy of pursuing all debtors to discourage other customers from defaulting.

Accounting provision for doubtful debts

21. Persons in business who provide credit often find it prudent to make some accounting provision for the likelihood that some of their debtors will not pay. This allowance is generally calculated by estimating a percentage on the basis of past history, and applying that percentage to the total amount of debts owed to the business at balance date.
22. However, for tax purposes, bad debts are individually identifiable debts that are unlikely to be recovered (in practical terms). For accounting purposes, the provision for doubtful debts is an estimate of the amount that will become bad debts in the future. The ITA and the GST Act do not allow any deduction for provisions for doubtful debts.

Debts that are partially bad

23. In some cases there may be no reasonable expectation that the debt will be fully recovered, but there may be a reasonable expectation of partial recovery. In this instance, it is only that part of the debt that the creditor has no reasonable expectation of recovering that the creditor is entitled to write off as bad and (if all other relevant requirements are satisfied) to claim as a deduction for income tax and GST purposes.

Bad debts recovered

24. Under s CG 3 of the ITA, when a person receives an amount on account of a bad debt for which a deduction for income tax has previously been allowed, they must include the amount as income in the income tax return for the year in which it is received.
25. Under s 26(2) of the GST Act, when a person recovers an amount on account of a bad debt (whether it is for the whole or part of the debt) in respect of which a deduction from output tax has previously been allowed, that portion of the amount of the deduction previously allowed, as the amount that the bad debt recovered bears to the bad debt written off, shall be deemed to be the GST charged in relation to a taxable supply made during the taxable period in which the bad debt is wholly or partially recovered.

Examples of when a debt is bad

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

Example 1

A supplier has supplied goods on credit to Mr B. Mr B owes the supplier $2,000 for the goods. The supplier knows that Mr B has left town, and that mail addressed to him is returned marked "Gone No Forwarding Address".

In this case it is reasonable to assume that the debt will not be recovered. The money owed by Mr B is a bad debt.

Example 2

C owes $100,000 to a company. The credit controller for the company has considered the likelihood of default on every loan currently owing to the company. The credit controller has estimated the likelihood of default for C to be 5%, and wants to know if the company can consider $5,000 of that loan (5% of the $100,000 owing) to be a bad debt.

Making an estimate of the likelihood of default on debts is not sufficient for a debt (or a percentage of it) to be bad. It is not reasonable to assume that the debt is bad.

Example 3

A local dairy has supplied $64 worth of bread and cigarettes to Mrs D on credit. Mrs D used to call into the shop every other day, but has not called into the shop for eight weeks and the dairy has heard that someone else is living in the house Mrs D used to rent. The $64 is still owing.

Given the relatively small amount owing and the information known to the dairy, it is reasonable for the dairy to make no further enquiries. On the basis of the dairy's information, it can be assumed that the money is unlikely to be recovered. It is a bad debt. However, if the sum involved was somewhat larger, it may be reasonable to expect the dairy to make further enquiries.

Example 4

A solicitor has done work for Mr O and billed him for $1,700. The solicitor is on the Board of Trustees of the school attended by Mr O's children. The solicitor has sent out a number of reminder bills because the bill is four months overdue, but has had no response. Several of the solicitor's friends and associates have mentioned that Mr O is in financial difficulty and has had one of his vehicles repossessed. The solicitor's office clerk has noted that Mr O's name has been cited in the *Gazette* several times over recent months in respect of court action for unpaid debts.

It is reasonable for the solicitor to characterise Mr O's debt as a bad debt.

Example 5

A debtor of Mr F is a company in liquidation. Mr F has given the liquidator notice of a debt of $10,000 owed for goods and services supplied. Mr F is an unsecured creditor. The liquidator has held a meeting of creditors. Mr F attended the meeting and received formal notice of the outcome of the meeting. The liquidator has stated that unsecured creditors will probably receive something between 45 and 50 cents in the dollar.

It is reasonable for Mr F to assume that $5,000 of the total debt is bad. He is entitled to write off that part of the debt that is bad in the income year in which he received the formal notice, and to claim a deduction for income tax and GST purposes.

Example 6

The same facts exist as in Example 5, but at a later date Mr F receives a letter from the liquidator who advises that the estimate of the likely recovery has been revised. It is now expected that unsecured creditors will be paid between 70 and 75 cents in the dollar.

This does not affect the answer given above in Example 5. Also, it has no effect on Mr F's GST return or income tax return if Mr F has claimed a deduction for the bad debt. If at any stage Mr F receives payment of any part of the 50 cents in the dollar written off, Mr F must:

- include it as gross income in the income tax return for the year in which it is received (this will give rise to an income tax liability unless there are losses to offset against it, and may give rise to a provisional tax liability, depending on the taxpayer's circumstances); and
- account for GST on the amount recovered in the same proportion as Mr F was allowed a deduction from output tax when the bad debt was written off.

Second requirement – debt must be "written off"

27. Subject to all other relevant legislative requirements being satisfied, both the ITA and the GST Act allow taxpayers and/or registered persons a deduction for a bad debt that has been written off. It is not sufficient that a debt is bad – the bad debt must also have been actually written off. Writing off the bad debt is important because the time this occurs establishes the relevant income year or GST taxable period in which a deduction becomes available. Judge Barber stated in *Case Z21* (2010) 24 NZTC 14,286 that:

> Three elements must be satisfied: the debt is bad; a decision has been made to write off the bad debt; and the appropriate bookkeeping entries have been made to record that the bad debt has been written off.
>
> …
>
> The purpose of the requirement, that bookkeeping records show the debt to actually be written off, is to provide certainty as to the very point of [time] when the write-off actually occurred.

BINDING RULINGS

28. Note that there is no requirement that a debt be written off in the year it becomes bad. As Tompkins J stated in the High Court decision of *Budget Rent A Car*:

    A debt is not normally deductible. It does not become a deductible debt if and when it becomes a bad debt. It becomes a deductible debt, if it has been incurred in the production of assessable income, when it is written off. It is the writing off that converts the debt into a deductible debt. It follows that the crucial time is the time of the writing off, not the time the debt becomes a bad debt. It also follows that the income year referred to in s 106(1)(b)[s DB 31(1)(a)(i)] is not the year the debt became bad. In my view, the income year referred to is the year during which the bad debt was "actually written off".

    There is no provision in the Act that requires the bad debt to be written off in the year the debt became bad. Had that been the intention of the legislature, it would have said so ...

29. Judge Barber discussed the requirement to write off bad debts in the Taxation Review Authority (TRA) decision *Case N69* and stated:

    I consider it that it is elementary that the writing off of a debt as bad requires something more than the mere recognition by the taxpayer, or one or more of its executives, that a debt is unlikely to be paid. It could be reasoned that only a decision of the taxpayer to write off a debt is needed, subject to the debt being bad. However, I consider that, in terms of s 106(1)(b) [s DB 31(1)(a)(i)], book-keeping steps must also be taken to record that the debt has been written off. Desirably, the steps would comprise a directors' resolution, if the taxpayer is a corporate, and appropriate book-keeping entries. However, it would be adequate for a responsible officer or executive of a corporation or business to merely make the appropriate book entries if he or she has that authority. An unincorporated sole trader or small unincorporated business would not, of course, have a directorate so that book entries by the trader or his or her manager will suffice. In my view, it is not possible to write off a debt as bad without the making of authorised journal entries in the books of account of the business.

30. In *Case T48* (1998) 18 NZTC 8,325 the TRA held that for a private individual trader, as distinct from an incorporated company, words on ledger cards such as "written off" with the relevant date are sufficient to indicate that the debt had been actually written off as a bad debt. The taxpayers did not have to meet any other bookkeeping requirements. Judge Barber stated:

    In *Case N69* I contemplated that the businessperson concerned… would decide that a debt was bad in good faith and in terms of his (or her) business knowledge, and make an authorised journal entry in his books of account. He could simply record his decision somewhere in the records of the business. In the case of a company one might expect a resolution of the directors confirming a decision or report of management to write off a debt as bad; although, as I said in *Case N69* the executive personnel would normally have the authority to write off bad debts. As already indicated, the notation on the ledger cards written at some stage by T is less than I had contemplated in *Case N69*, but in the circumstances of this case is adequate to show an actual writing off. As Judge Willy said in *Case P53* [(1992) 14 NZTC 4,370], there is no one formula for the mechanics of writing off a debt, but the taxpayer [must] satisfy the Court, on the balance of probabilities, that the debt has, in fact, been written off in whatever books of account or accounting procedures are kept by the taxpayer.

31. Therefore, to meet the legislative requirements in s DB 31(1)(a)(i) of the ITA and s 26(1)(c) of the GST Act, rather than just making a decision that the debt is bad, taxpayers must be able to show clearly that the debt has actually been written off. To show that this is the case, there must be something written down in the business's account books stating that the debt is written off.

32. Case law indicates that the minimum written requirements necessary to satisfy the "written off as bad" test may vary for different classes of taxpayer based on the differing nature and level of sophistication of the taxpayer's accounting records. However, no matter what form a taxpayer's account books or accounting records may take, those existing for a debt owed by a bad debtor must record that the taxpayer, or an authorised person on behalf of the taxpayer, having decided the debt is bad, has written off the debt accordingly. Writing off the bad debt is what converts it into a potentially deductible debt (depending on whether the other legislative requirements relating to deductibility of bad debts, such as the capital limitation are met).

33. What will be sufficient to meet the "written off" test for various classes of taxpayer are set out below. The classes and the written requirements are based largely on *Case N69*, *Case T48* and the earlier *Case P53* (1992) 14 NZTC 4,370. The bad debt is "written off" in accordance with the accounting and record keeping systems maintained by the taxpayer when:

    - in the case of a large corporate or business taxpayer who maintains a computerised bad debts system, an authorised person makes the appropriate entry in that system recording the debt as written off; or
    - in the case of a company (other than one set out as above), an executive or other responsible officer of the company with the authority to do so, makes the appropriate bookkeeping entries in the company's account books recording the debt as written off; or

BINDING RULINGS

- in the case of a taxpayer (other than a company) who maintains double-entry accounts, an authorised person makes the appropriate bookkeeping entries in the business's account books recording the debt as written off; or
- in the case of a taxpayer who is an unincorporated sole trader or small unincorporated business taxpayer who does not maintain double-entry accounts, the taxpayer makes a note in their bookkeeping records setting out the amount owed by the bad debtor, stating that the debt has been written off, and recording the date of the writing off.

34. There may be very exceptional cases where something less than the writing-off requirements set out above are acceptable. In *Case S73* (1996) 17 NZTC 7,454, the taxpayer was unable to access their accounting records and a letter was sent to the Commissioner stating that the debt had been written off. The TRA stated that it was a question of fact whether a particular debt had been written off and was satisfied on the evidence before it that it clearly had been. Nevertheless, there remains a written requirement in all cases.
35. Further details of the specific form the write-off of a bad debt may take in the creditor taxpayer's books are outlined in the next section of this commentary.
36. The time a debt is written off determines when a deduction can be claimed. Therefore, the necessary writing-off must take place before the end of the income year or GST taxable period when the bad debt deduction is claimed. Writing off a bad debt cannot be backdated. If there are numerous debts, it is important to allow sufficient time to review them and complete all necessary "writing-off" accounting entries before the end of an income year or GST taxable period, to enable any bad debt deductions to be claimed in that year or GST taxable period.
37. In all cases, business records kept by the taxpayer must comply with the requirements of s 22 of the Tax Administration Act 1994 and s 75 of the GST Act.

Accounts kept by taxpayers

38. Most taxpayers in business keep double-entry accounts. If a person keeps double-entry accounting records, the bad debt must be struck out of the records on which the double-entry accounts are based. If debtors ledgers are maintained, the writing-off will be clearly shown by appropriate bookkeeping entries in the debtors ledger by authorised persons. Generally, this means the balance in the debtors ledger for the individual debtor must be reduced by the amount of the bad debt. No matter what processes are followed when preparing a taxpayer's double-entry accounts, having made the decision that the debt is bad (in accordance with the tests already outlined), it is essential to make the appropriate authorised entry/entries writing off the debt before claiming a deduction.
39. In cases where a taxpayer does not keep double-entry accounting records and/or does not keep a debtors ledger, the taxpayer must write the debt off according to the form of records used. This means that whatever the form of records used, those showing the amount owed by the bad debtor must clearly record that the creditor, having made the decision that the debt is bad (in accordance with the tests already outlined), has written the debt off accordingly.
40. Particular examples of bad debts accepted by the Commissioner as having been written off include the following:
    - If a taxpayer's only records of debts are copies of invoices issued, placing the invoice in a "bad debts" file and indicating by way of a dated written note on the invoice whether all or part of the invoiced amount is bad, is sufficient.
    - If a taxpayer's only records of debts are copies of invoices and copies of statements of account issued from a duplicate account book, marking the copy of the final statement sent out "bad debt – written off" (noting the amount of the debt that is bad and the date) is sufficient. Alternatively, it would also be sufficient for the taxpayer to place the relevant invoice in a "bad debts" file indicating on the invoice whether all or part of the invoiced amount is bad and the date this was done.

Keeping records for credit control or other purposes

41. For a variety of reasons, a creditor may keep a separate record of written-off bad debts. For example, the records may be necessary if the creditor should ever have the opportunity of collecting the debt in the future, or the creditor may want to keep a record of problem customers to avoid future difficulties.
42. As long as these records are quite separate from the accounting base records they will not affect the write-off. If the creditor ceases to recognise the debt as an asset for accounting purposes by removing it from the accounting base records, it is written off.

More than one set of accounts

43. Some businesses have more than one set of accounts. For example, a company may prepare:
    - financial accounts for financial reporting purposes to satisfy the requirements of the Companies Act 1993; and
    - management accounts as a basis for management decision-making and control.
44. The sets of accounts may be prepared in quite different ways. For example, statutory requirements are set out in the Financial Reporting Act 2013 for preparing financial reports that are not required when preparing management accounts; and management accounts may be prepared on the basis of estimates for some elements to provide very quick reports.
45. When the different sets of accounts rely on the same underlying debtor records, no difficulty arises. As long as the creditor ceases to recognise the debt as an asset for accounting purposes by removing it from the accounting base records, it is written off. However, if the debt is still recognised as an asset in the underlying records, it is not written off.
46. If the different sets of accounts rely on different underlying debtor records (which is very rare), the creditor should refer to the accounts that are relied on to represent the firm's financial position. For a company, these will be the accounts used to satisfy the company's financial reporting obligations under the Companies Act 1993.

Examples of when a bad debt is or is not written off

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

General facts

The following facts apply to all the following examples:

- The taxpayer's income tax balance date is 31 March.
- The only question is whether a debt has been written off. All other criteria relating to the deductibility of the debt for income tax and GST purposes are satisfied.
- The debt is for goods and services supplied for money.
- The supply has been included in the taxpayer's gross income for income tax purposes.

In the examples where the taxpayer is a GST-registered person, the following additional facts apply:

- GST returns are filed on a two-monthly invoice basis.
- The supply has been included in a GST return.

Example 1

The taxpayer maintains a debtors ledger and is not registered for GST. The debtors ledger is updated on 31 March 2017. The entries made include the journal entry writing off the bad debt.

The bad debt will have been written off in the year ending 31 March 2017.

Example 2

The taxpayer maintains a debtors ledger and is not registered for GST. The debtors ledger is written up on 1 April 2017. The entries written up include the journal entry writing off the bad debt.

The bad debt will have been written off in the year ending 31 March 2018.

Example 3

The taxpayer does not maintain a debtors ledger and is registered for GST. There is no indication on her underlying debtor records to show the status of the debt. She has claimed a deduction from output tax for the bad debt in her GST return for the taxable period ending 31 January 2017. That return was prepared in February 2017.

The taxpayer is not entitled to the deduction from GST output tax. Claiming the deduction from output tax for GST purposes is not a sufficient writing-off of the bad debt for either GST or income tax purposes. She is not allowed a deduction for the bad debt in the income year ending 31 March 2017.

Example 4

The taxpayer does not maintain a debtors ledger and is not registered for GST. The taxpayer's only records of debts owing to him are copies of issued invoices. The taxpayer maintains only rudimentary account books and his unpaid debtors are represented by loose-leaf filing of accounts and/or invoices issued in a ring-binder file. When a debt is paid, it (the account and/or invoice) is transferred to a separate file. The taxpayer ceases sending accounts for the debt in question in February 2017, putting a line across the copy of the last statement sent out for the debt and marking it "Final" and leaves it in the unpaid debtors' file.

The bad debt will not have been written off in the year ended 31 March 2017. Simply marking the last statement issued as "Final" and leaving it in the unpaid debtors' file does not amount to writing off the debt.

Example 5

The taxpayer does not maintain a debtors ledger and is not registered for GST. His only records of debts owing are copies of invoices and statements issued. In February 2017 the taxpayer became aware that a debt was bad. He stopped sending out statements for the debt and took no other action on it. In particular, he sent out no statements on the account in February and March 2017. The taxpayer continued to send out statements on all the other debts owing, including overdue accounts. The taxpayer keeps carbon copies of the statements of account in the duplicate account book from which the statements for issue are prepared. The taxpayer has tagged the final statement sent out for the debt, circling the amount payable and marking it "bad debt – written off – February 2017".

The bad debt will have been written off in the year ending 31 March 2017. The cessation of statements of account, recorded by their absence in the duplicate account book, and the tagging and marking of the final statement, amount to writing off the debt in his accounting system.

Example 6

The taxpayer maintains a debtors ledger and is not registered for GST. She wrote up the debtors ledger on 31 March 2017. The entries written up include a journal entry writing off a bad debt. Her accountant prepares her accounts in June 2017. In the course of preparing the accounts, the accountant makes a general ledger entry recognising the bad debt as a result of the debtors ledger entry made by the taxpayer on 31 March 2017.

The bad debt will have been written off in the year ending 31 March 2017 because the underlying accounting record of the debt was altered to recognise the bad debt on 31 March 2017.

Example 7

The taxpayer does not maintain a debtors ledger and is not registered for GST. Her only records of debts owing are copies of invoices issued. On 15 March 2017 she placed the invoice for the debt in question in a file marked "BAD DEBTS" noting on the invoice next to the total amount "debt bad – filed 15/3/17". The amount of trade debtors in the taxpayer's balance sheet as at 31 March 2017 includes the bad debt. The taxpayer's profit and loss statement for the year ending 31 March 2017 includes as income the sale that has become a bad debt. The profit and loss statement does not recognise any expense for bad or doubtful debts.

The taxpayer's income tax return for the year ending 31 March 2017 includes the profit and loss statement and a "tax reconciliation statement" showing the difference between the accounting income and the amount she believes to be income for income tax purposes. The tax reconciliation statement includes a deduction for the bad debt.

The taxpayer is not allowed a deduction for the bad debt. Although the debt has arguably been written off in the underlying accounting records, she has not ceased to recognise the debt as an asset for accounting purposes.

The taxpayer would be allowed a tax deduction in the 2017 year if they used an accountant to complete their accounts for the year, perhaps to complete their income tax return, and that person made the required journal entries through the profit and loss statement and balance sheet to give effect to the write off of the bad debt made by the taxpayer on 15 March 2017. In that case the bad debt write off will be included in the profit and loss statement and balance sheet for the 2017 year and there would be no tax adjustment required in the tax reconciliation statement.

Example 8

The taxpayer has a computer-based accounting software system where they enter all business receipts and invoices. The accounting software automatically updates the underlying ledger accounts when each transaction is entered.

The taxpayer considers an invoice a bad debt on 5 February 2017, and she enters a "Bad Debt" transaction into her accounting software on the same day.

The taxpayer is allowed a deduction for the bad debt. Entering a "Bad Debt" transaction into her accounting software system will automatically update the underlying accounting records as at that date, and the debt will no longer be recognised as an asset in the accounts produced for the 2017 year ie, it will have gone through the profit and loss account and be removed from debtors in the balance sheet.

References

Expired rulings

BR Pub 96/3A: Bad debts – Writing off debts for GST and Income Tax Purposes (which applied for a three year period)

BR Pub 00/03: Bad debts – Writing off debts for GST and Income Tax Purposes (which applied for a five year period)

BR Pub 05/01: Bad debts – Writing off debts for GST and Income Tax Purposes (which applied for an indefinite period)

Subject references

Bad debt, written off

Legislative references

Income Tax Act 2007 – ss CG 3, DB 31

Goods and Services Tax Act 1985 – ss 26, 75

Tax Administration Act 1994 – s 22

Case references

Budget Rent A Car Ltd v CIR (1995) 17 NZTC 12,263

Case 45/93 93 ATC 486, 27 ATR 1022

Case N69 (1991) 13 NZTC 3,541

Case P53 (1992) 14 NZTC 4,370

Case S73 (1996) 17 NZTC 7,454

Case T27 (1997) 18 NZTC 8,188

Case T48 (1998) 18 NCTC 8,325

Case W3 (2003) 21 NZTC 11,014

Case Z21 (2010) 24 NZTC 14,286

Graham v CIR, Edwards Graham Ltd & Edwards v CIR (1995) 17 NZTC 12,107

Appendix – Legislation

Income Tax Act 2007

1. Section CG 3 provides:

CG 3 Bad debt repayment

An amount received by a person for a bad debt for which the person has been allowed a deduction is income of the person.

2. Section DB 31 provides:

DB 31 Bad debts

No deduction (with exception)

(1) A person is denied a deduction in an income year for a bad debt, except to the extent to which—

(a) the debt is a debt—

(i) written off as bad in the income year:

(ii) for which the debtor is released from making all remaining payments under the Insolvency Act 2006 excluding Part 5, subparts 1 and 2 of that Act, or under the Companies Act 1993, or under the laws of a country or territory other than New Zealand, and the person is required to calculate a base price adjustment by section EW 29 (When calculation of base price adjustment required) for the debt for the income year:

(iii) for which the debtor is a company that is released from making all remaining payments by a deed or agreement of composition, and the person is required to calculate a base price adjustment by section EW 29 for the debt for the income year; and

(b) in the case of the bad debts described in subsections (2) to (5), the requirements of the relevant subsection are met.

Deduction: financial arrangement debt: amount of income

(2) A person who derives assessable income from a financial arrangement to which the financial arrangements rules apply is allowed a deduction for an amount owing under the financial arrangement, but only to the extent to which—

(a) the amount is a bad debt and a requirement of subsection (1)(a) is met; and

(b) the amount is attributable to the income; and

(bb) the person is not associated with the debtor, or is associated with the debtor but the debtor has no deductions for the financial arrangement; and

(c) subsection (5) does not limit the deduction.

Deduction: financial arrangement debt: dealers and holders

(3) A person is allowed a deduction, quantified in subsection (3B), for an amount of a bad debt owing under a financial arrangement to which the financial arrangement rules apply, if—

(a) the person carries on a business for the purpose of deriving assessable income; and

(b) the business includes dealing in or holding financial arrangements that are the same as, or similar to, the financial arrangement; and

(c) a requirement of subsection (1)(a) is met for the bad debt; and

(d) the person is not associated with the person owing the amount written off.

Amount of deduction under subsection (3)

(3B) For the purposes of subsection (3), the amount of the deduction for the amount owing under the financial arrangement is the lesser of—

(a) the amount provided by subsection (4B); and

(b) the amount provided by subsection (5).

Deduction: financial arrangement debt: dealers in property or services

(4) A person is allowed a deduction for an amount owing under a financial arrangement to which the financial arrangements rules apply, but only to the extent to which—

(a) the amount is a bad debt and the requirement of subsection (1)(a)(i) is met; and

(b) the financial arrangement is an agreement for the sale and purchase of property or services; and

(c) the person carries on a business of dealing in the property or services that are the subject of the agreement; and

(d) the person carries on the business for the purpose of deriving assessable income; and

(e) subsection (5) does not limit the deduction.

Amount for purposes of subsections (3) and (3B)

(4B) For the purposes of subsections (3) and (3B), the amount is the least of—

(a) the amount of consideration that the person pays for acquiring the financial arrangement:

(b) the amount owing under the financial arrangement:

(c) the amount calculated using the following formula, treating the calculation of a negative amount as zero:
amount owing − limited recourse consideration + adjustment amount.

Definition of items in formula

(4C) In the formula in subsection (4B)(c),—

(a) amount owing is the lesser of—

(i) the amount of consideration that the person pays for acquiring the financial arrangement:

(ii) the amount owing under the financial arrangement:

(b) limited recourse consideration is the amount of consideration paid to the person under a limited-recourse arrangement that relates to the financial arrangement:

(c) adjustment amount is an amount allocated for the income year under section EW 15D (IFRS financial reporting method) for the limited-recourse arrangement, to the extent to which the amount arises solely because of the reduction in the value of the limited-recourse arrangement due to the financial arrangement's relevant bad debt amount.

Limited recourse: base price adjustment

(4D) If subsection (4B)(c) applies for an amount owing under a financial arrangement, then the person is allowed a deduction, at the time the person performs a base price adjustment for the related limited-recourse arrangement, of an amount equal to the amount owing under the financial arrangement minus the total amount of deductions for the financial arrangement under subsections (2) and (3) that have arisen before the base price adjustment.

Definition of items in formula [Repealed]

(4E) *[Repealed]*

Deduction: bad debt representing loss already offset

(5) A person is allowed a deduction for a bad debt only to the extent to which it is more than the total of the amounts offset under section IC 1 (Company A making tax loss available to company B) that are described in paragraphs (e) and (f) if—

(a) the person writing off the amount of debt is a company (company A); and

(b) the debt is owed to it by another company (company B); and

(c) company B—

(i) itself uses the amount giving rise to the debt; or

(ii) uses it to fund directly or indirectly another company (company C) that uses the amount; and

(d) company B or company C has a tax loss, in the calculation of which the amount used is taken into account; and

(e) company A, or a company that is part of the same group of companies as company A at any time in the income year in which company B or company C has the tax loss, offsets an amount for the tax loss under section IC 1; and

(f) the offset is in a tax year before the tax year that corresponds to the income year in which company A writes off the amount of debt, but not before the 1993–94 tax year.

A definition

(5B) In this section, limited-recourse arrangement means, in relation to an amount owing under a financial arrangement (the debt), an arrangement that is for the person's business of dealing in or holding financial arrangements, and that provides for payment or non-payment by the person, contingent upon—

(a) payment of some or all of the debt to the person:

(b) failure to make payment of some or all of the debt to the person.

Link with subpart DA

(6) The link between this section and subpart DA (General rules) is as follows:

(a) subsection (1) overrides the general permission; and

(b) for subsections (2) to (5),—

(i) they supplement the general permission, to the extent to which they allow a deduction that is denied under the general permission; and

(ii) they override the general permission, to the extent to which they deny a deduction that is allowed under the general permission; and

(iii) the general limitations still apply, except that subsections (3) and (4D) override the capital limitation for a financial arrangement held as part of a business that includes dealing in or holding financial arrangements.

Goods and Services Tax Act 1985

3. Section 26 provides:

26 Bad debts

(1) Where a registered person—

(a) has made a taxable supply for consideration in money; and

(b) has furnished a return in relation to the taxable period during which the output tax on the supply was attributable and has properly accounted for the output tax on that supply as required under this Act; and

(c) has written off as a bad debt the whole or part of the consideration not paid to that person,—

that registered person shall make a deduction under section 20(3) of that portion of the amount of tax charged in relation to that supply as the amount written off as a bad debt bears to the total consideration for the supply:

provided that where goods are supplied under a hire purchase agreement, the registered person shall only make a deduction under section 20(3) of the tax fraction (being the tax fraction applicable at the time that the hire purchase agreement was entered into) of that portion of the amount written off as a bad debt as the cash price bears to the total amount payable under the hire purchase agreement:

(1AA) Subsection (1) also applies if a registered person sells a debt to a third party and then reacquires the debt.

(1AB) A registered person who is required to account for tax payable on a payments basis under either section 19 or section 19A must apply this section only to supplies made by the person to which any one of sections 9(2)(b), 9(3)(b) and 26A applies.

(1A) Where a registered person has, in respect of the supply by that registered person of any contract of insurance (being a supply charged with tax pursuant to section 8(1)),—

(a) paid any amount to the Earthquake and War Damage Commission pursuant to the Earthquake and War Damage Act 1944 or to the Fire Service Commission pursuant to the Fire Service Act 1975 or to Fire and Emergency New Zealand pursuant to the Fire and Emergency New Zealand Act 2017; and

(b) sought to recover that amount, together with the consideration for that supply, from the recipient of that supply; and

(c) written off as a bad debt the whole or part of that amount not paid to that registered person,—

that registered person shall make a deduction under section 20(3) of the tax fraction of that amount or that part of that amount written off.

(2) Where any amount in respect of which a deduction has been made in accordance with subsection (1) is at any time wholly or partly recovered by the registered person, that portion of the amount of the deduction allowable under subsection (1) as the amount of the bad debt recovered bears to the bad debt written off shall be deemed to be the tax charged in relation to a taxable supply made during the taxable period in which the bad debt is wholly or partly recovered.

(3) This section does not apply when the taxable supply is one made by a principal to an agent as described in section 60(1B)(a) if the agent has been paid for the supply described in section 60(1B)(b).

(4) This section does not apply when the taxable supply is made by an agent to a principal as described in section 60(2B)(b).

Notice of Withdrawal of a Public Ruling

1. This is a notice of withdrawal of a public ruling made under section 91DE of the Tax Administration Act 1994.
2. Public Ruling BR Pub 05/01 "Bad Debts – Writing off debts as bad for GST and income tax purposes" applies for an indefinite period beginning on 1 April 2004.
3. Public Ruling BR Pub 05/01 is withdrawn from 31 August 2018.

BR Pub 05/01 is being withdrawn because it has become outdated and does not reflect the increased use by taxpayers of computer-based accounting software. On withdrawal, the Commissioner will continue to be bound by it for arrangements entered into on or before the withdrawal date for a further three years (see s 91DE(4A) of the Tax Administration Act 1994).

A new replacement public ruling, BR Pub 18/07 "Income Tax and Goods and Services Tax – Writing off debts as bad" is being published with effect from 1 September 2018. The replacement ruling will apply to any new arrangements entered into on or after 1 September 2018. Taxpayers may choose whether to apply the new ruling to their existing arrangements, but after 31 August 2021 the new ruling will apply to **all** arrangements regardless of when they were entered into.

Fiona Wellgreen
Senior Tax Counsel, Taxpayer Rulings

INTERPRETATION STATEMENTS

This section of the *TIB* contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

In most cases Inland Revenue will assess taxpayers in line with the following interpretation statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of the assessment we consider that the earlier advice is not consistent with the law.

IS 18/03: Income tax – attribution rule for income from personal services

All legislative references are to the Income Tax Act 2007 (ITA 2007) unless otherwise stated. Relevant legislative provisions are reproduced in the appendix to this Interpretation Statement.

Summary

1. This Interpretation Statement provides guidance on when the attribution rule for income from personal services in ss GB 27 to GB 29 will apply. It expands on "Attribution of Income" *Tax Information Bulletin* Vol 12, No 12 (December 2000): 49. It does not discuss or explain the calculation rules contained in s GB 29.

2. The attribution rule for income from personal services in ss GB 27 to GB 29 is a specific anti-avoidance rule that prevents an individual avoiding the top personal tax rate by diverting income to an associated entity. Essentially, the income attribution rule applies when an individual (the working person), who performs personal services, is associated with an entity (the associated entity) that provides personal services to a third person (the buyer).

3. The income attribution rule only applies where various threshold tests are met and no exemptions apply. This Interpretation Statement provides guidance on the application of each of those threshold tests and exemptions, to assist readers in determining whether the income attribution rule applies to their situation.

Introduction

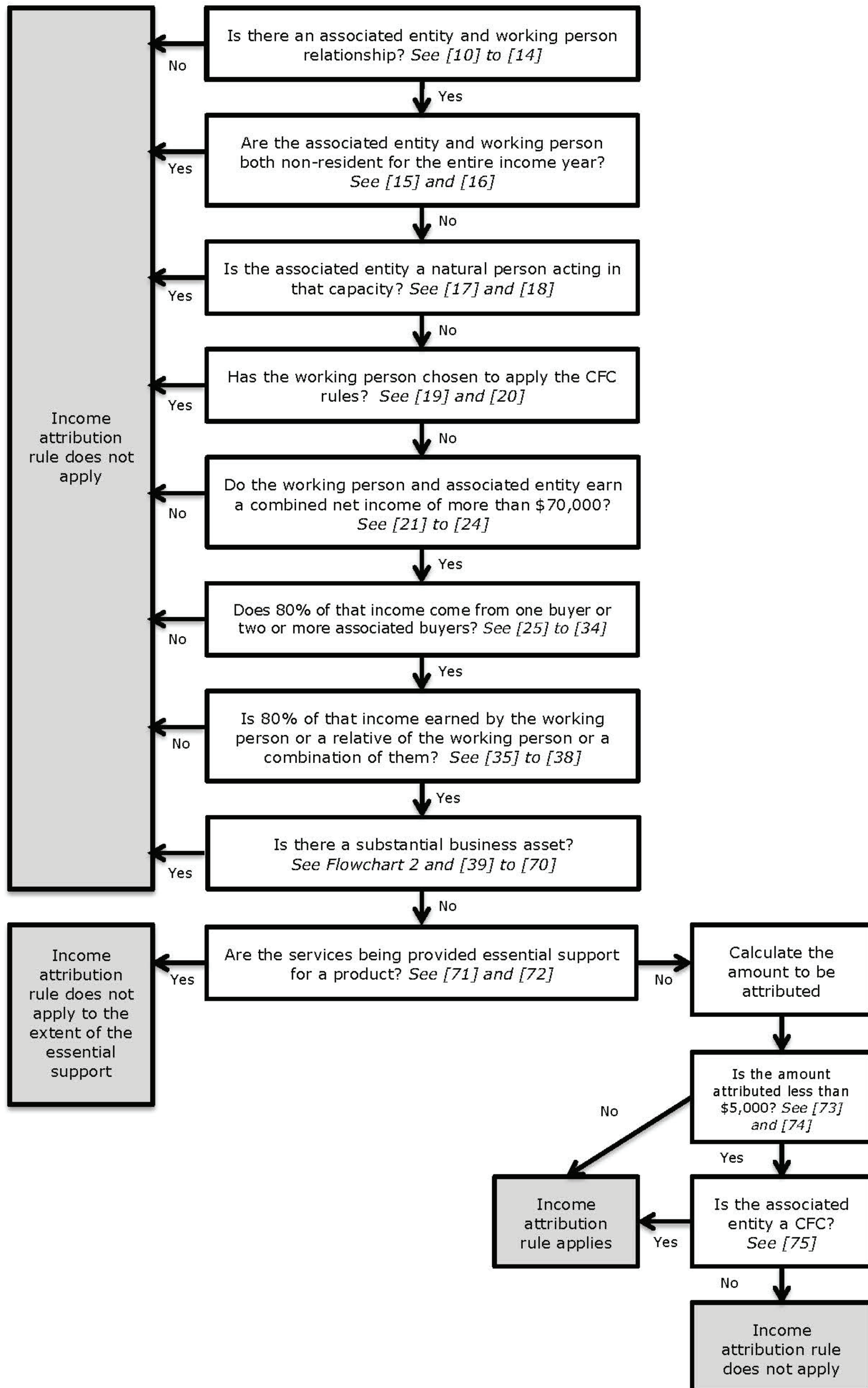
4. The income attribution rule applies where (s GB 27(1)):
    - a person (the working person) provides personal services;
    - the working person is associated with an entity (the associated entity);
    - the associated entity is inserted between the working person and the party who acquires the services (the buyer);
    - the working person performs the services, but the associated entity derives the income;
    - various threshold tests in s GB 27(2) are satisfied; and
    - none of the exemptions in s GB 27(3) apply.

5. This Interpretation Statement focuses on the application of the threshold tests in s GB 27(2), and the exemptions in s GB 27(3).

6. The threshold tests that must be satisfied for the income attribution rule to apply are:
    - 80% or more of the associated entity's income from personal services during the income year is derived from the supply of services to the buyer or an associate of the buyer or a combination of them (s GB 27(2)(a)); and
    - 80% or more of the associated entity's income from personal services during the income year is derived from services that are performed by the working person or a relative of the working person or a combination of them (s GB 27(2)(b)); and
    - the working person's net income for the income year exceeds $70,000, including any amounts that would be attributed if the rule applied (s GB 27(2)(c)); and
    - substantial business assets are **not** a necessary part of the business structure used to derive the entity's assessable income (s GB 27(2)(d)).

7. However, even if the threshold tests are satisfied, a working person and an associated entity will be exempt from applying the income attribution rule where:
   - the associated entity and the working person are non-residents;
   - the associated entity is a natural person, and is neither a partner of a partnership nor a trustee of a trust;
   - the services performed by the working person are essential support for a product supplied by the associated entity;
   - the amount to be attributed to the working person is less than $5,000 (although there are exclusions to this); or
   - in various situations where the associated entity is a controlled foreign company (CFC).
8. A process for considering the application of the various thresholds and exemptions is illustrated in Flowchart 1 on the next page.
9. The analysis following the flowchart discusses each of the threshold tests and any exclusions in the order that they appear in the flowchart.

Flowchart 1: Does the income attribution rule apply?



Is there an associated entity and working person relationship?

10. The income attribution rule will only apply where the entity is associated with the working person.

11. The rules in subpart YB apply to determine whether a working person and an entity are associated persons. A company and a person (other than a company) will be associated if the person has a voting interest in the company of 25% or more (s YB 3).

12. If the entity and the working person are not associated, the income attribution rule will not apply.

Example 1. Identifying the parties

Paul employs Andrea. Andrea is paid a salary of $150,000.

Andrea incorporates a company called A&M Co Ltd which contracts her services to Paul. Andrea is the sole shareholder of A&M Co Ltd. Paul pays A&M Co Ltd $150,000 for the services provided. A&M Co Ltd pays Andrea a salary of $80,000 and retains the remaining $70,000.

Question

Who are the relevant parties under the income attribution rule?

Answer

Under the new arrangement, Paul is the buyer, A&M Co Ltd is the associated entity and Andrea is the working person for the purposes of the income attribution rule.

Who	Attribution party	Contractual party	Original party
Paul	Buyer	Buyer	Employer
A&M Co Ltd	Associated entity	Employer	None
Andrea	Working person	Employee	Employee

13. The income attribution rule is not restricted to reorganisations of existing situations. It also applies to new structures where the appropriate relationships are created. The income attribution rule is also not confined to a corporate structure. The associated entity could be, for example, a trust or a partnership, and the working person could be a partner, trustee or beneficiary of a trading trust. The rules in subpart YB will also apply to determine whether a working person is associated with a partnership or trust. In particular, a partner and a partnership will be associated persons (s YB 12), and a trustee of a trust will be associated with the beneficiaries (s YB 6) (and people related to the beneficiaries (s YB 5)) and settlors of the trust (s YB 8), and with a person with the power to appoint or remove the trustee (s YB 11).

14. Most of the examples given in this item are based on a corporate structure because that is likely to be the most common structure. However, the analysis is equally applicable to other less common business structures where the income attribution rule may apply such as a trading trust or partnership.

Example 2. Identifying the parties

Jane and Megan have just established the JM Partnership. Jane completes all the work for the partnership while Megan has contributed the capital. The JM Partnership has entered into a substantial contract with Bug Eliminators Ltd which will take almost all of Jane's time.

Question

Who are the relevant parties under the income attribution rule?

Answer

Under the arrangement Bug Eliminators Ltd is the buyer, JM Partnership is the associated entity and Jane is the working person for the purposes of the income attribution rule.

Are the associated entity and working person both non-resident for the entire income year?

15. Under s GB 27(3)(a), the income attribution rule will not apply if the associated person and the working person are **both** non-resident during the relevant income year under the tests in ss YD 1 (Residence of natural persons) and YD 2 (Residence of companies). For more guidance on the application of the residence tests see "IS 16/03: Tax Residence" *Tax Information Bulletin* Vol 28, No 10 (October 2016): 2.

16. The residence or non-residence of the working person is the first matter to address when considering this exemption. It will only be necessary to consider the residence of the associated entity if the working person is a non-resident.

Example 3. Non-resident working person and resident associated entity

John is a non-resident who owns all of the share capital of NZCO which is a New Zealand incorporated company. John is the working person and NZCO is the associated entity. NZCO provides consulting services to one buyer, which is an Australian company. The services are provided to the buyer in Australia and the work is done by John in Australia.

Question:

Does the income attribution rule apply?

Answer:

Yes, the income attribution rule applies. The exemption in s GB 27(3)(a) provides that **both** the associated entity (NZCO) and working person (John) must be non-residents at all times. While John is not a New Zealand tax resident, NZCO is incorporated in New Zealand so is a company that is a New Zealand resident for tax purposes. There may be some relief for a working person under the Australia/New Zealand double tax agreement, but this item does not consider the application of any relevant double tax agreements.

Example 4. Tax resident working person

Michelle is New Zealand tax resident who is living in France. She owns all of the share capital of NZCO which is a New Zealand incorporated company. Michelle is the working person and NZCO is the associated entity. NZCO provides consulting services to FRENCHCO, which is the sole buyer of the services that NZCO provides. Michelle provides the services in France.

Question:

Does the income attribution rule apply?

Answer:

Yes, the income attribution rule applies. The exemption in s GB 27(3)(a) provides that **both** the associated entity (NZCO) and the working person (Michelle) must be non-residents at all times. In this example Michelle (the working person) is a New Zealand tax resident. This means the requirements of s GB 27(3)(a) are not met.

Example 5. Non-resident associated entity

Bryan was a New Zealand tax resident but he currently lives in the United Kingdom and is a non-resident at all relevant times. He owns all of the share capital of BRITCO which is a UK company. Bryan is the working person and BRITCO is the associated entity. BRITCO provides consulting services to UKCO, which is the sole buyer of the services that BRITCO provides. Bryan provides the services in the United Kingdom.

Question:

Does the income attribution rule apply?

Answer:

No, the income attribution rule does not apply. The exemption in s GB 27(3)(a) provides that **both** the associated entity (BRITCO) and the working person (Bryan) must be non-residents during the relevant income year. In this example the associated entity (BRITCO) is not a New Zealand tax resident and neither is Bryan (for the time being). This means the requirements of s GB 27(3)(a) have been satisfied even though the working person (Bryan) is a New Zealander.

Is the associated entity a natural person acting in that capacity?

17. The income attribution rule will not apply if the associated entity is a natural person and is neither a partner of a partnership nor a trustee of a trust (s GB 27(3)(b). The income attribution rule is designed to prevent higher income earners from diverting personal services income to associated people by using companies, trusts and look-through companies. Section GB 27(3)(b) was added after the income attribution rule was enacted so that if a sole trader employs relatives to carry out personal services of a type to which the income attribution rule would otherwise apply, all the income from those services is not directed to those relatives. If the income attribution rule did apply the sole trader would have no income from those services.

18. However, if the natural person is acting in their capacity as a partner of a partnership, or a trustee of a trust, opportunities may still exist for the natural person to divert personal services income. Accordingly, the exemption does not apply in these situations.

Has the working person chosen to apply the controlled foreign company rules?

19. The income attribution rule will not apply (s GB 27(3)(e)) if:
    - the associated entity is a CFC (that is, a foreign company that is controlled by five or fewer New Zealand residents); and
    - the amount that would be attributed to the working person under the income attribution rules would also be attributed CFC income under s CQ 2(2B) (When attributed CFC income arises) or an attributed CFC loss under s DN 2(2) (When attributed CFC loss arises); and
    - the working person files a return of income in which they return the amount as attributed CFC income.

20. This exemption prevents double taxation through the application of multiple regimes by allowing the working person to choose to apply the CFC rules or the income attribution rules.

Do the working person and associated entity earn a combined net income of more than $70,000?

21. The income attribution rule will only apply if the working person's net income from personal services for the income year is more than $70,000, assuming the income derived by the associated entity is attributed to the working person under the income attribution rule (s GB 27(2)(c)). The $70,000 must be calculated by applying all of the calculation rules contained in s GB 29 including the loss restriction rules contained in s GB 29(1).

22. This threshold is designed to ensure the income attribution rule does not apply if the working person's net income for the year, calculated in accordance with all of the rules contained in s GB 29, is less than $70,000 (which is the income level at which the 33% top marginal rate of tax commences). If the working person's net income, calculated in accordance with all of the rules contained in s GB 29, would always be less than $70,000 there are limited tax advantages from interposing the associated entity between the working person and the buyer.

23. The working person's income is calculated by reference to income that would have been earned if the income attribution rule applied. This is effectively the income that the working person would have had, if the associated entity had not been interposed.

Example 6. Income earned by working person

Lauraco (the associated entity) earns $100,000 this year and pays a salary of $60,000 to Laura (the working person).

Question

Has Laura earned more than $70,000 for the purposes of the attribution rule?

Answer

Yes, Laura has earned more than $70,000 if the income attribution rule applies. As the amount paid as a salary to Laura is under the $70,000 threshold Laura might argue that the income attribution rule does not apply. However, if the income attribution rule applied a further $40,000 would be attributed by the associated entity. Accordingly, Laura's net income for the purposes of this threshold requirement is $100,000, not just the $60,000 paid.

24. When calculating the amount of income for the working person it is necessary to also consider the taxable value of any fringe benefit the working person receives (s GB 28(5)).

Does 80% of that income come from one buyer or two or more associated buyers?

25. The income attribution rule will only apply where 80% of the associated entity's total income is from one buyer or from two or more buyers if those buyers are associated persons (s GB 27(2)(a)).
26. The inclusion of this requirement ensures that contracts are not divided between existing entities associated with the buyer, or that the buyer does not incorporate new companies to ensure the 80% threshold is not met.
27. To determine whether two buyers are associated, the general associated persons rules in subpart YB apply. In summary, the associated persons rules treat two people as being associated where they are:
    - two companies, if either a group of persons hold total voting interests in each company of 50% or more, or if the group of persons control both companies by any other means;
    - a company and a person (other than a company) if the person has a voting interest in the company of 25% or more;
    - relatives;
    - a trustee of a trust and:
        - a beneficiary of the trust;
        - the settlor of the trust;
        - a person who is related to a beneficiary;
        - a trustee of another trust with the same settlor; or
        - a person with the power to appoint or remove the trustee;
    - a settlor of a trust and a beneficiary of the trust;
    - a partnership and a partner (excluding limited partnerships, which are treated as companies);
    - a look-through company and a look through owner who is a director or employee; or
    - each associated with a third person .
28. This Interpretation Statement does not go into detail about the application of the associated persons provisions. For more information see "New Definitions of 'Associated Persons'" *Tax Information Bulletin* Vol 21, No 8 (October/November 2009): 75.

Example 7. Associated persons – two buyers

Bob owns all of the share capital of Bobco and is the sole employee of Bobco. Bob is the working person and Bobco is the associated entity. The buyers of Bobco's services are AUSCO and its wholly owned subsidiary NZCO. Both of the buyer companies have entered into **separate** contracts with Bobco which will each provide 40% of Bobco's total income. Bobco is aware that NZCO is a wholly owned subsidiary of AUSCO.

Question:
Does Bob earn 80% of his income from the buyer and a person associated with the buyer?

Answer:
Yes, Bob does earn 80% of his income from the buyer and a person associated with that buyer. AUSCO and NZCO are associated with each other, which means 80% of Bobco's total income is derived from the supply of services to a combination of the buyer and a person associated with the buyer (that is, AUSCO and NZCO).

Example 8. Associated persons – buyer with multiple customers

Ann owns all of the share capital of Service Ltd and is the sole employee of Service Ltd. The buyer of Service Ltd's services is Computersupport Ltd which provides a wide variety of computer services to 15 third party clients. Service Ltd has no clients apart from Computersupport Ltd. The contract between Service Ltd and Computersupport Ltd requires Service Ltd to provide direct "helpdesk" services as and when required to all of the 15 third party clients of Computersupport Ltd.

Question

Is Ann providing her services to one buyer?

Answer:

Yes, Ann is providing her services to one buyer. Ann is the working person and Service Ltd is the associated entity. The associated entity Service Ltd has only one client, Computersupport Ltd, which is the buyer. It is irrelevant that Service Ltd is providing computer helpdesk services to Computersupport Ltd's 15 clients. There are no contracts between Service Ltd and the 15 third party clients of Computersupport Ltd.

Example 9. Associated persons – buyer and associated entity associated

Alan owns all of the share capital of Parent Ltd, Manufacturing Ltd, Distribution Ltd and Retail Ltd. Alan is the sole employee of Parent Ltd and is the working person. Parent Ltd is the associated entity that provides services to the three sister companies Manufacturing Ltd, Distribution Ltd and Retail Ltd, which are the buyers. Parent Ltd does not provide services to any other taxpayers.

Question:

Is Alan providing all his services to one buyer?

Answer:

Yes, Alan is providing all his services to one buyer. Parent Ltd, Manufacturing Ltd, Distribution Ltd and Retail Ltd are associated with each other which means all of Parent Ltd's income is derived from the supply of services to a combination of the buyer and persons associated with the buyer (that is, Manufacturing Ltd, Distribution Ltd and Retail Ltd).

29. The income attribution rule may apply one year to an associated entity and cease to apply the next year. This could happen where an associated entity is working for one buyer but changes its contract midway through the year to a different, unassociated buyer.

30. This situation was considered when the income attribution rule was enacted and the decision was that although the rule may be arbitrary in this regard, the preference was to keep the rule simple to understand and apply.

Example 10. Change of buyers

Fiona (the working person) has been providing 100% management services, through her associated entity FJH Ltd, to a payroll company for years. Six months into the current income year, that contract ends and Fiona and the associated entity contracts for six months with a different, unassociated, independent payroll company. The new contract is on the same terms and for the same amount as the previous contract.

Question:

Will the income attribution rule apply to FJH Ltd for the current income year?

Answer:

No, the income attribution rule will not apply to FJH Ltd for the current income year. Because Fiona is earning the same amount in relation to each unassociated buyer, she can only be earning 50% from one buyer and the income attribution rule will not apply.

There was only one buyer in the year before the change, so the income attribution rule does apply to that year. It is also possible that the income attribution rule may apply to the year after the change (if there are no other buyers).

31. Section GB 28 also contains rules relating to associated persons that are relevant when determining whether two buyers are associated. A person is only treated as being associated with another person for the income attribution rule if they are associated at the time the working person performs the services (s GB 28(2)). Also, no association exists between two buyers where both of them are public authorities (s GB 28(3)(a)).
32. Finally, there will be no association between two buyers where the working person cannot reasonably be expected to know that the two buyers are associated, other than by making a specific inquiry (s GB 28(3)(b)). An example of this would be if the working person were providing services to a company (an arm's length third party) that is part of a large group, and that company had several related companies (also arm's length) that were also contracting with the working person.
33. There is a difference between a person "knowing" that parties are associated (which would be subjective) and being "reasonably expected to know". The use of the words "reasonably expected to know" rather than just "know" indicates that it is an objective test. Accordingly, the question is whether a reasonable person should know.
34. The Commissioner considers that the working person should reasonably be able to know that two buyers may be associated where the associated buyers have similar names, where the working person was contracting with the same person on behalf of two buyers, where there is obvious and immediately accessible public information available to the working person about the buyers, or where there is local or regional knowledge of the association. The requirement that the person should be "reasonably expected to know" will depend on the facts and circumstances of each case.

Example 11. Associated persons - knowledge

Clare owns all of the share capital of Clareco and is the sole employee of Clareco. Clare is the working person and Clareco is the associated entity. The buyers of Clareco services are AUSCO and its wholly owned subsidiary NZCO. Both buyer companies have entered into **separate** contracts with the associated entity that will each provide 50% of Clareco's total income. Clare is not aware that NZCO is a wholly owned subsidiary of AUSCO. The buyers have different company names, and different employees entered into the contracts with the associated entity.

Question:

Can Clare be reasonably expected to know that AUSCO and NZCO are associated buyers?

Answer:

No, Clare cannot be reasonably expected to know that a particular buyer (NZCO) is associated with another buyer (AUSCO) without making specific enquires. The working person (Clare) is not aware of the 100% common shareholding between AUSCO and NZCO and would not reasonably be expected to know they are associated because:

– The two buyers have different company names.

– The two contracts were negotiated and entered into with different employees of NZCO and AUSCO.

However, the answer might be different if AUSCO and NZCO were in the same industry and the services Clare provided were very similar with overlap between the first and the second contract in terms of timeframes, price and so on.

Is 80% of that income earned by the working person or a relative of the working person or a combination of them?

35. The income attribution rules will only apply where 80% or more of the associated entity's income from personal services during the income year is derived through services personally performed by the working person, a relative of the working person, or a combination of both of them (s GB 27(2)(b)). The inclusion of personal services performed by a relative of the working person is designed to ensure personal services cannot be split between relatives to make them appear to fall outside the income attribution rules. A common example would be where the services are provided by spouses or by a parent and an adult child.
36. "Relative" is defined in s YA 1 as a person connected with another person by being:
    - within the second degree of blood relationship to the other;
    - in a marriage, civil union, or de facto relationship with the other;
    - in a marriage, civil union, or de facto relationship with a person who is within the second degree of blood relationship to the other;
    - adopted as a child of the other or as a child of a person who is within the first degree of relationship to the other; or
    - the trustee of a trust under which a relative has benefited or is eligible to benefit.

37. This definition is consistent with the meaning of "relative" in the associated persons provisions, and covers parents, siblings and children.

38. The definition of "relative" is, however, limited by s GB 28(4) for the purposes of the income attribution rules. Section GB 28(4) states that a person is a relative of the working person only if the person is a relative at the beginning of the relevant income year. As an example, if during an income year two persons who each provide services to the entity begin a de facto relationship, they will not be caught within the provision until the next income year. However, if two people are in a de facto relationship, but split up during the year, they will be treated as being associated for the purposes of the income attribution rule for that income year.

Example 12. Relatives of working person

Dawn and her spouse Richard own all of the share capital of D&Dco. Dawn is the only full time employee of D&Dco. Richard and their adult children Diana and David are equally capable of providing the same services that would otherwise have been provided by Dawn. D&Dco is the associated entity. There is a single buyer of D&Dco services. The contract between D&Dco *and the buyer* provides that 50% of the services will be provided by Dawn and 50% of the services will be provided by Richard. The contract also provides that Richard can arrange for all or a proportion of his services to be provided by Diana or David or both.

Question:

Are Dawn and her relatives providing more than 80% of their services to a buyer?

Answer:

Yes, Dawn and her relatives are providing more than 80% of their services to a buyer. More than 80% (in this case 100%) of the services provided by D&Dco will be provided by a combination of the working person (Dawn) and the relatives of Dawn (Richard, Diana or David).

Are there substantial business assets?

39. The income attribution rules will not apply if the associated entity:
    - has "substantial business assets"; and
    - those assets are a necessary part of the business structure that is used to derive the associated entity's income from the provision of personal services to the buyer.

40. If the associated entity does not have substantial business assets, or those assets are not a necessary part of the business structure that is used to derive gross income from the provision of personal services, then income attribution may be required (subject to the application of the other thresholds and exemptions discussed in this Interpretation Statement) (s GB 27(2)(d)).

41. The substantial business assets test is designed to recognise that when substantial business assets are used in the associated entity's business of providing personal services there should also be a return on that capital. For example, the owner-driver of a petrol tanker should receive a return based on both the asset employed and the labour provided.

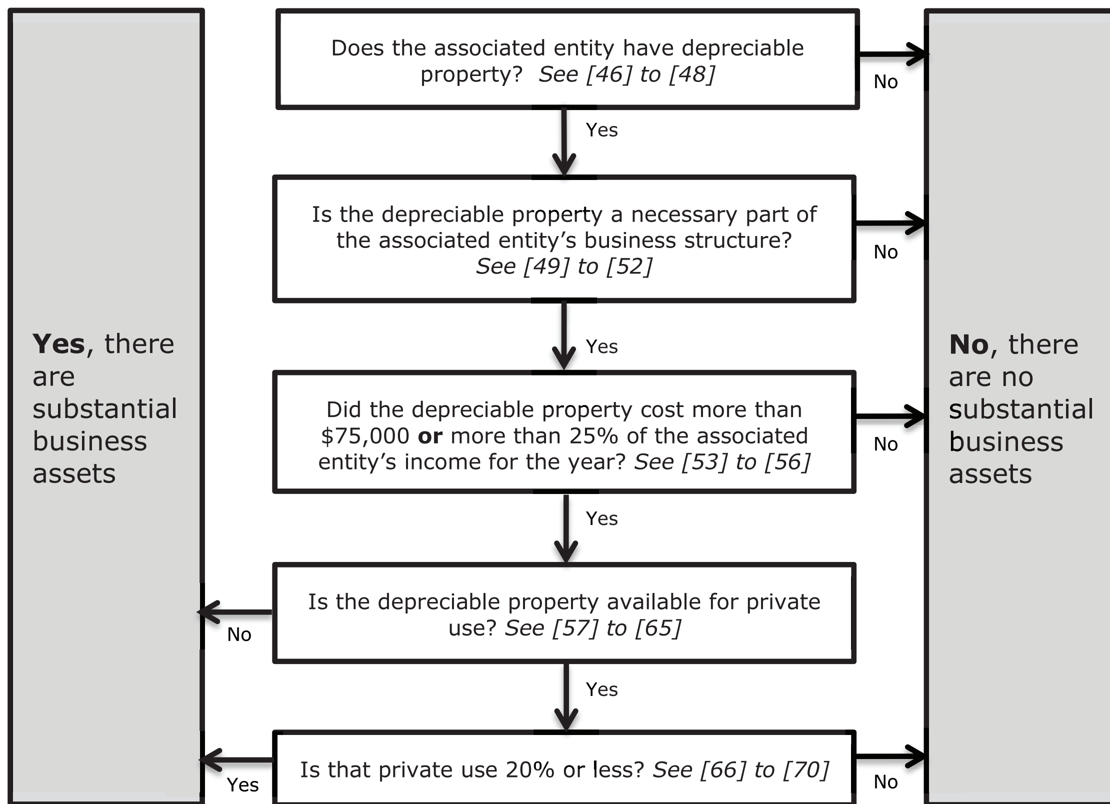
42. The expression "substantial business assets" is defined in s GB 28(6) as depreciable property that:
    - has a total cost of more than:
        - $75,000; or
        - 25% or more of the associated entity's total income from services for the income year; and
    - is not for "private use", which will not apply where the private use of the depreciable property is 20% or less of its total use (s GB 28(8)).

43. "Substantial business assets" can comprise a single asset or multiple assets.

44. The questions that need to be considered to determine whether an associated entity has substantial business assets are summarised in Flowchart 2.

45. The text following the flowchart to [85] considers each question in the order that it appears in the flowchart.

Flowchart 2: Are there substantial business assets?



Does the associated entity have depreciable property?

46. As stated above, to have a "substantial business asset", an associated entity must have property that is "depreciable property".

47. "Depreciable property" is, generally, defined as being property that, in normal circumstances, might reasonably be expected to decline in value while it is used or available for use in deriving assessable income, or in carrying on a business for the purpose of deriving assessable income (s EE 6). Depreciable property includes items that are "depreciable intangible property" (listed in sch 14). These items include property such as a patent or the right to use a patent, and the right to use a copyright. However, "depreciable property" does not include items of property that are listed in s EE 7, such as land, trading stock, and financial arrangements.

48. To be depreciable property, the substantial business assets must be used, or available for use, to derive the associated entity's assessable income from the provision of personal services. Not all property will automatically satisfy this requirement. Property that is used for private use is unlikely to satisfy this test. This is consistent with the definition of "substantial business assets".

Is the depreciable property a necessary part of the associated entity's business structure?

49. As discussed above, it is a requirement that the depreciable property be a necessary part of the associated entity's business structure that is used to provide personal services to the buyer. The first step is to identify the business that the associated entity is undertaking and then the structure that is being used. In most cases the business being undertaken by the associated entity will be self-evident. It can then be considered whether the particular assets being considered (to be substantial business assets) are a necessary part of the business structure.

50. An associated entity's "business structure" is the structure or organisation that has been established to carry out the associated entity's contractual obligations to the buyer of the working person's services (*CIR v Trustpower Ltd* (2016) 27 NZTC 22-010 (CA); *Sun Newspapers Ltd v FCT* (1938) 5 ATD 87 (HCA)).

51. The dictionary definitions of "necessary" indicate that the depreciable property must be essential, vital, indispensable or imperative to the success of the activity being performed. Case law indicates that the word "necessary" can have a narrow or a wide interpretation depending on the statutory context. In the context of the income attribution rule, which is a specific anti-avoidance rule, the Commissioner's view is that the word "necessary" should be narrowly interpreted (*Pabari v Secretary of State for Work and Pensions* [2005] 1 All ER 287).

52. Therefore, it is the Commissioner's view that business assets must be indispensable or essential to the provision of the particular services provided by the working person to the buyer of those services. Tools and equipment that are only infrequently (if at all) used by a working person to perform the personal services provided to a buyer of the personal services may not satisfy the narrow test of indispensability.

Example 13. Necessary business tools

Wendy the plumber is the working person. She is a very experienced plumber and is employed by her associated entity. The associated entity's business is providing plumbing services. The associated entity owns all of the plumbing equipment that Wendy needs to carry out her work and a van to carry that equipment. The buyer is constructing a large commercial building that will take at least three years to build.

Question

Are the plumbing equipment and van a necessary part of the business structure?

Answer

Yes the plumbing equipment and the van owned by the associated entity are a necessary part of the associated entity's business structure.

Example 14. Necessary business tools

Barry the builder is the working person. Barry is employed by his associated entity which runs a business providing building services. All of the income of the associated entity is from a single buyer. The buyer owns all of the building equipment that Barry needs to carry out the buyer's building contract. The buyer also provides a vehicle to transport Barry from the buyer's premises to the construction site.

The associated entity owns some equipment that is not used for building and it is stored at Barry's private residence. Barry uses a motor vehicle owned by the associated entity to drive from his private residence to the buyer's premises. Barry then uses the buyers building equipment and motor vehicle to travel to the construction site.

Question

Are the associated entity's equipment and motor vehicle a necessary part of the business structure?

Answer

No, based on the facts provided the associated entity's equipment and motor vehicle are not necessary parts of the business structure (while the motor vehicle may be a necessary part of the business structure more information would be needed before this could be decided). The equipment owned by the associated entity is not a necessary part of the business structure because it does not relate to the business of the associated entity and the buyer provides Barry with all of the building equipment necessary.

Did the depreciable property cost more than $75,000 or more than 25% of the associated entity's income for the year?

53. Depreciable property will only be a "substantial business asset" if it has a total cost of more than (s GB 28(6)(a)):

- $75,000; or
- 25% or more of the associated entity's total income from services for the income year.

54. These are alternative tests, **either** of which must be satisfied.

55. This test requires the taxpayer to correctly ascertain the relationship between the cost of their depreciable property and the two statutory thresholds. It is "cost" and not market value that is relevant. The "cost" will be the same as the cost the associated entity uses for depreciation purposes.

56. The most common categories of business assets owned by associated entities include motor vehicles, tools and equipment, computers and communication equipment.

Example 15. Substantial business assets – monetary thresholds

Cost of depreciable property	$40,000
Total income from services	$120,000
25% of total income from services	$30,000
Statutory amount	$75,000

Question

Does the asset meet the monetary threshold?

Answer

Yes, the asset meets the monetary threshold. The cost of the depreciable property is $40,000 which is **less** than the statutory amount of $75,000. The first limb of the test is not satisfied. However, the cost of $40,000 is **more** than 25% of income from personal services which is $30,000. The second limb of the test is satisfied.

Example 16. Substantial business assets – monetary thresholds

Cost of depreciable property	$50,000
Total income from services	$240,000
25% of total income from services	$60,000
Statutory amount	$75,000

Question

Does the asset meet the monetary threshold?

Answer

No, the asset does not meet the monetary threshold. The cost of the depreciable property is $50,000 which is **less** that the statutory amount of $75,000. The cost is also **less** than 25% of income from personal services which is $60,000. The test has **not** been satisfied because the taxpayer has failed both of the alternative tests.

Example 17. Substantial business assets – monetary thresholds

Cost of depreciable property	$80,000
Total income from services	$280,000
25% of total income from services	$70,000
Statutory amount	$75,000

Question

Does the asset meet the monetary threshold?

Answer

Yes. The asset meets the monetary threshold. The cost of the depreciable property is $80,000 which is **more** than the statutory amount of $75,000. The cost is also **more** than 25% of income from personal services which is $70,000. The test is satisfied because the taxpayer has satisfied both of the alternative tests (and only one test needs to be satisfied).

Example 18. Substantial business assets – monetary thresholds

Cost of depreciable property	$80,000
Total income from services	$360,000
25% of total income from services	$90,000
Statutory amount	$75,000

Question

Does the asset meet the monetary threshold?

Answer

Yes, the asset meets the monetary threshold. The cost of the depreciable property is $80,000 which is **more** than the statutory amount of $75,000. The first of the alternative tests has been satisfied. It does not matter that the cost of $80,000 is **less** than 25% of income from personal services which is $90,000. The test is satisfied because the taxpayer is required to satisfy only one of the alternative tests.

Is the depreciable property used for private use?

57. Depreciable property may not be a "substantial business asset" if it is used for private use (subject to the 20% test discussed from [66]).
58. The Act does not contain a general definition of "private use". The dictionary definitions relevantly indicate that "private" refers to the part of a person's life that is concerned with situations or activities in a person's personal relationships and activities rather than with the person's work or business relationships (*CIR v Haenga* (1985) 7 NZTC 5, 198 (CA)).
59. Many business assets, such as computers, printers, tablets, smart phones tools and equipment, are capable of being used for both business and non-business activities. In relation to the use of such assets, the Commissioner considers that any use that is not in the course of undertaking specific income earning activities should be classified as private use.

Private use of motor vehicles

60. The Act contains a specific definition of "private use" for motor vehicles. Under s CX 36, private use for a motor vehicle includes:
    - the employee's use of the vehicle for travel between home and work; and
    - any other travel that confers a private benefit on the employee (for example, use after hours, during the weekend or when the working person is on leave).
61. Section GB 28(9), which sets out how to calculate the percentage of private use of a substantial business asset (discussed from [66]), refers to the number of days for which fringe benefit tax (FBT) is payable for the property. Because FBT is payable for motor vehicles depending on their private use, this definition is also relevant when determining the private use of a motor vehicle for the purposes of the substantial business asset test.
62. This Interpretation Statement briefly discusses where there will be private use of a motor vehicle. For more information on this topic see "Travel by Motor Vehicle Between Home and Work – Deductibility of Expenditure and FBT Implications" *Tax Information Bulletin* Vol 16, No 10 (November 2004): 31 (IS 3448), and IS 17/07 "Fringe Benefit Tax – Motor Vehicles" *Tax Information Bulletin* Vol 29, No 9 (October 2017): 12.

Travel between home and work

63. In most cases, the Commissioner considers that travel between home and work in a vehicle owned by an associated entity will confer a private advantage and be considered private use of that vehicle. However, where a **home is also a workplace** and an employee is **required for sound business reasons** to travel to perform employment duties partly at the home workplace and partly at another workplace, then no private benefit will be conferred by that travel (*CIR v Schick* (1998) 18 NZTC 13,738 (HC)).
64. If the working person's home is also the associated entity's premises, and sound business reasons exist for this arrangement, travel in a motor vehicle from the home to the buyer's premises will be considered work-to-work travel. This travel will not be considered private use for s GB 28(6)(b).
65. If the associated entity's premises are separate from the working person's home, the standard rules relating to FBT and motor vehicles as set out in IS 17/07 and IS3448 apply. It is likely that any travel between home and those premises in a motor vehicle will be considered private use under s GB 28(6)(b).

Is the private use 20% or less?

66. The phrase "private use" is limited for the purposes of the income attribution rule so that where the private use of the depreciable property is 20% or less of its total use it will not be considered private use (s GB 28(8)).
67. This limitation means depreciable property may satisfy the test for substantial business assets even if there is an element of private use or enjoyment, provided the level of private use is not more than 20% of the total use. Or, to put it another way, the classification of an asset as a substantial business asset will not change in cases where the business use of that asset is at least 80%.
68. Section GB 28(9) provides guidance on calculating the percentage of private use of a business asset.
69. In the case of property that is subject to the FBT rules, the percentage of private use must be calculated by comparing the number of days for which FBT is payable with the total days in the tax year in which the property is owned or is subject to a specified lease, a finance lease or a hire purchase agreement.
70. In the case of all other property (including any property that is excluded from FBT under s CX 21), the percentage of private use must be calculated by comparing the expenditure relating to the property that is non-deductible as a result of the private use with the total expenditure relating to the property incurred in the tax year.

Are the services being provided essential support for a product?

71. The income attribution rule will not apply to the extent that the services provided by a working person are essential support for a product supplied by the working person's associated entity (s GB 27(3)(c)).

72. Various dictionary definitions suggest that the word "product", when read in this context, describes the sale of something that has been produced or acquired by the associated entity that is sold to the buyer.

Example 19. Essential support for a product

Computer Comprehensive Service Ltd is the associated entity that has entered into a contract with its only customer, a government department (the buyer). The contract requires Computer Comprehensive Service Ltd to install a new computer system, provide software and hardware support and provide "hands on" training to the buyer's staff. All of the staff training will be undertaken by the working person at the buyer's premises.

Question:

Does the income attribution rule apply?

Answer:

No, the income attribution rule does not apply. Computer Comprehensive Service Ltd (the associated entity) has agreed to provide the government department (the buyer) with a computer system, software and hardware support, and comprehensive hands on training. The training services the working person provides are essential support for the hardware and software (the product) that Computer Comprehensive Service Ltd sold to the government department.

Is the amount being attributed less than $5,000?

73. The income attribution rule will not apply where the total amount to be attributed to the working person by the associated entity is less than $5,000. This means that if the amount attributed under s GB 29 is less than $5,000, no attribution need be made (s GB 27(3)(d)).

74. However, if the working person has more than one associated entity, this exemption can apply only once (s GB 27(3)(d)(i)). This means the second entity must attribute income regardless of the level of that income.

Is the associated entity a controlled foreign company?

75. The $5,000 exemption will not apply if the associated entity is a CFC. This is to ensure that all income from CFCs is returned regardless of the amount. A separate exemption that may apply for CFCs is discussed at [19] and [20].

References

Subject references

associated persons
attribution of income from personal services
controlled foreign companies
income tax

Legislative references

Income Tax Act 2007 – ss CQ 2, CX 21, CX 36, CX 38, DN 2, EE 6, EE 7, EX 1, GB 27 to GB 29, in s YA 1 ("associated persons", " car", "motor vehicle", "relative"), subpart YB, ss YD 1, YD 2, sch 14

Land Transport Act 1998, s 2 ("motor vehicle")

Case references

Case P26 (1992) 14 NZTC 4,196 (TRA)
Case R37 (1994) 16 NZTC 6,208 (TRA)
Case S26 (1994) 17 NZTC 7,182 (TRA)
Case T38 (1997) 18 NZTC 8,255 (TRA)
CIR v Haenga (1985) 7 NZTC 5,198 (CA)
CIR v Schick (1998) 18 NZTC 13,738 (HC)
CIR v Trustpower Ltd (2016) 27 NZTC 22-010 (CA)
Pabari v Secretary of State for Work and Pensions [2005] 1 All ER 287 (EWCA Civ)
Sun Newspapers Ltd v FCT (1938) 5 ATD 87 (HCA)

Other references

"Attribution of Income" Tax Information Bulletin *Vol 12, No 12 (December 2000): 49*
"IS 16/03: Tax Residence" Tax Information Bulletin *Vol 28, No 10 (October 2016): 2*
"IS 17/07: Fringe Benefit Tax – Motor Vehicles" Tax Information Bulletin *Vol 29, No 9 (October 2017): 12*
"New Definitions of 'Associated Persons'" Tax Information Bulletin Vol 21, No 8 (October/November 2009): 75
"Travel by Motor Vehicle between Home and Work – Deductibility of Expenditure and FBT Implications" Tax Information Bulletin *Vol 16, No 10 (November 2004): 31*

Appendix – Legislation

Sections GB 27 to GB 29 provide:

GB 27 Attribution rule for income from personal services

Application of section GB 29

(1) An amount of income in an income year of a person (the associated entity) is attributed to another person (the working person) under section GB 29 for the working person's corresponding tax year if,—

(a) during the income year, a third person (the buyer) acquires services from the associated entity, and the services are personally performed by the working person; and

(b) the working person is associated with the associated entity; and

(c) the threshold test in subsection (2) is met; and

(d) none of the exemptions in subsection (3) applies.

Threshold for application of attribution rule

(2) The attribution occurs only if—

(a) 80% or more of the associated entity's total income from personal services during the income year is derived from the supply of services to the buyer, a person associated with the buyer, or a combination of them; and

(b) 80% or more of the associated entity's income from personal services during the income year is derived through services personally performed by the working person, a relative of the working person, or a combination of them; and

(c) the working person's net income for the income year, assuming section GB 29 applies in relation to the associated entity and working person, is more than $70,000; and

(d) substantial business assets are not a necessary part of the business structure that is used to derive the total income referred to in paragraph (a).

Exemptions

(3) The attribution does not occur—

(a) if both the associated entity and the working person are non-residents at all times during the associated entity's income year:

(b) if the associated entity is a natural person and is neither a partner of a partnership nor a trustee of a trust:

(c) to the extent to which the services personally performed by the working person are essential support for a product supplied by the associated entity:

(d) if the total amount to be attributed to the working person, for the associated entity and the income year, is less than $5,000, unless—

(i) the application of this paragraph would prevent income being attributed to the working person for the income year in relation to another associated entity:

(ii) the associated entity is a CFC and a person who holds an attributing interest in the CFC files, after the date (the Royal assent date) on which the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 receives the Royal assent, a return of income in which the amount of income attributed to the working person is determined under this section:

(e) if the associated entity is a CFC and—

(i) the amount gives rise to attributed CFC income under section CQ 2(2B) (When attributed CFC income arises) or attributed CFC loss under section DN 2(2) (When attributed CFC loss arises) for a person who holds an attributing interest in the CFC; and

(ii) the person who holds the attributing interest in the CFC files, after the Royal assent date, a return of income in which the amount attributed to the working person is determined under section EX 20B (Attributable CFC amount).

Treatment of certain dividends

(4) If a company that is required to attribute an amount to the working person under this section pays a dividend, sections HA 14 to HA 19 (which relate to qualifying companies) are treated as applying to the company and the dividend if the company—

(a) has no net income for the tax year in which it pays the dividend other than income attributed under this section, ignoring interest income that is incidental to the company's business; and

(b) is not a qualifying company; and

(c) chooses to have the dividend treated as if it were paid by a qualifying company.

Cancellation of notional imputation credits

(5) For the purposes of subsection (4), to the extent to which the dividend paid by the company would have had an imputation credit attached that arose under section OB 16 (ICA attribution for personal services) in the absence of the election made under subsection (4)(c), the credit is treated as cancelled immediately before it would have been attached under sections HA 14 to HA 19 (which relate to dividends paid by qualifying companies).

GB 28 Interpretation of terms used in section GB 27

When this section applies

(1) This section applies for the purposes of section GB 27.

Associated persons

(2) A person is treated as being associated with another person if they are associated at the time the services are personally performed by the working person.

Non-associated buyers

(3) For the purposes of section GB 27(2)(a), a buyer is not treated as being associated with another buyer if either—

(a) both buyers are public authorities; or

(b) the working person cannot be reasonably expected to know that a particular buyer is associated with another buyer, other than by making a specific enquiry.

Relatives

(4) For the purposes of section GB 27(2)(b), a person is a relative of the working person only if the person is a relative at the beginning of the relevant income year of the working person.

Fringe benefits included

(5) For the purposes of section GB 27(2)(c), the working person's annual gross income includes the taxable value of a fringe benefit, as determined under sections RD 25 to RD 63 (which relate to fringe benefit tax), provided or granted by a person associated with the working person.

Meaning of substantial business assets

(6) Substantial business assets means depreciable property that—

(a) at the end of the associated entity's corresponding income year, has a total cost of more than either—

(i) $75,000; or

(ii) 25% or more of the associated entity's total income from services for the income year; and

(b) is not for private use.

Assets subject to finance lease, hire purchase agreement, or specified lease

(7) For the purposes of subsection (6)(a), the cost of depreciable property includes—

(a) the consideration provided to the lessee in the case of property subject to a finance lease or a hire purchase agreement, including expenditure or loss incurred by the lessee in preparing and installing the finance lease asset for use, unless the lessee is allowed a deduction for the expenditure or loss, other than a deduction for an amount of depreciation loss:

(b) the cost price, in the case of property subject to a specified lease.

Private use of assets

(8) Subsection (6)(b) does not apply to depreciable property if 20% or less of the property's use is for private use.

Calculation of private proportion of use

(9) For the purposes of subsection (8), the percentage of a property's use for private purposes for an income year is calculated according to—

(a) the proportion that the number of days for which fringe benefit tax is payable by the associated entity in relation to the property bears to the total number of days in the income year in which the property is owned by or is subject to a finance lease, hire purchase agreement, or specified lease, involving the associated entity, if the property is subject to the FBT rules:

(b) the proportion that the expenditure incurred in relation to the property, for which a deduction is denied to the associated entity, bears to all expenditure incurred by the associated entity in relation to the property in the income year, if the property is not subject to the FBT rules.

GB 29 Attribution rule: calculation

Amount attributed

(1) A working person is treated as deriving income in an income year equal to the least of the following amounts:

(a) the associated entity's net income for the corresponding tax year, calculated as if their only income were derived from personal services:

(b) the associated entity's net income for the corresponding tax year:

(c) if and to the extent to which the associated entity is a company or a trust that has a loss balance to be carried forward under section IA 4 (Using loss balances carried forward to tax year) arising from a business or a trading activity of supplying personal services, the associated entity's net income for the corresponding tax year after subtracting the loss balance carried forward from an earlier corresponding tax year.

Calculation for trustee or partnership

(2) For the purposes of calculating the associated entity's net income for the corresponding tax year in the application of subsection (1),—

(a) if the associated entity is a trustee of a trust, the trustees are treated as not having made a distribution of beneficiary income out of the year's income:

(b) if the associated entity is a partnership, the associated entity is treated as a taxpayer and section HG 2 (Partnerships are transparent) does not apply:

(c) if the associated entity is a look-through company, the associated entity is treated as a taxpayer and section HB 1 (Look-through companies are transparent) does not apply.

Salary paid or fringe benefits treated as deductions

(3) For the purposes of calculating the associated entity's net income for the corresponding tax year in the application of subsection (1),—

(a) the associated entity is allowed a deduction for employment income paid to the working person during the income year:

(b) the associated entity is allowed a deduction for the taxable value of a fringe benefit provided or granted by the associated entity to the working person during the income year, and for the fringe benefit tax payable on the fringe benefit.

Reduction of attributable income for distributions

(4) For the purposes of calculating the associated entity's net income for the corresponding tax year in the application of subsection (1), the amount of net income of the associated entity for the corresponding tax year is reduced by—

(a) in the case of a trustee of a trust, the amount of beneficiary income derived by the working person from the trust in the income year:

(b) in the case of a partnership, the share of profits allocated by the partnership to the working person:

(c) in the case of a company, a dividend paid—

(i) by the associated entity to the working person during the income year or before the end of 6 months after the end of the income year; and

(ii) from income derived in the income year.

Attribution reduced by market value of administrative services

(5) If the associated entity is a partnership that receives administrative services from another person related to their income from personal services and has not paid for the administrative services, the amount to be attributed to the working person is reduced by the market value of the administrative services provided by the other person.

Reduction of beneficiary income when rule results in trust having tax loss

(6) If the associated entity is a trustee and the amount attributable would cause the associated entity to have a tax loss for the corresponding tax year, for the purposes of this Act,—

(a) beneficiary income from the trust for the income year must be reduced to the extent to which the associated entity's taxable income for the corresponding tax year is zero; and

(b) the reduction in beneficiary income must be divided among the beneficiaries other than the working person—

(i) according to proportions determined by the trust's trustees:

(ii) if the trustees do not make the determination, according to the proportion that each beneficiary's beneficiary income bears to the total beneficiary income from the trust for the income year.

Attribution to more than 1 working person

(7) If the amount attributable is to be attributed to more than 1 working person, the share attributed to each working person must reflect the respective value of the services personally performed by each working person.

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 18/04: Options for relief from tax debt

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 (the "Statement") sets out the Commissioner's practice when considering the options for removing or deferring the obligation to pay tax, interest and/or penalties under the Tax Administration Act 1994. The options available to the Commissioner are to write off amounts, enter into an instalment arrangement, remit amounts, or a combination of these options.

Unless otherwise specified, all legislative references in this Statement refer to the Tax Administration Act 1994.

Application

This Statement applies to relief considered on or after 22 August 2018. It replaces 3 standard practice statements: SPS 11/01 – *Instalment arrangements for payment of tax*, SPS 15/02 – *Remission of penalties and use-of-money interest*, and SPS 15/03 – *Writing off outstanding tax.*

This Statement does not extend to child support obligations or student loan arrears. For more information on these, see SPS 11/02 *Child support debt – Requesting an instalment arrangement* and SPS 11/03 *Student Loans – Relief from repayment obligations*, or any statements issued in replacement.

Terminology

In this Statement the following terms are used. Please note their intended meaning for the purposes of this Statement:

Relief is to be interpreted in its context. It can refer to all forms of assistance covered by this Statement. It can include entering into instalment arrangements, writing off amounts owing under any ground, and the remission of interest and/or penalties.

Financial relief is a subset of "relief" and refers to relief granted as a result of financial hardship (that is, entering into an instalment arrangement, or writing off amounts owing when the test for serious hardship is met).

Interest refers to use-of-money interest payable by the taxpayer to the Commissioner under part 7 of the Act.

Amounts owing or **outstanding amounts** refer to any amounts of tax, interest and/or penalties which the taxpayer owes to Inland Revenue.

Standard practice

Summary

1. Taxpayers are required to pay their tax in full and on time. When they fail to do so late payment penalties may be applied and act as an incentive for taxpayers to comply with the law. In addition, interest may be payable to compensate the Commissioner for the loss of use of the money, and to encourage taxpayers to pay the correct amount of tax on time.

2. In certain situations however, the Commissioner may be able to provide assistance to taxpayers if they are not able to pay on time, or if the imposition of penalties and/or interest is not appropriate. Depending on the circumstances the Commissioner may be able to write off or remit amounts owing (so they do not need to be paid), or enter into an instalment arrangement (so the amount is paid over time rather than immediately). This Statement discusses the options that are available.

3. Where there is discretion about whether or not to grant relief, this decision rests with the Commissioner; while a taxpayer can apply for relief it is not available as of right. In addition to granting or denying relief, the Commissioner may choose to not take any immediate action in relation to a debt. This approach of waiting may be appropriate if, for example, the taxpayer's financial situation is not clear or the Commissioner considers that an unquantifiable amount is expected to be received by the taxpayer in the near future.

4. The options available to the Commissioner are not to be considered in isolation. For any amount of debt, the Commissioner may consider a combination of options. This is the case even if a taxpayer only requests one particular form of relief.

5. The options, and the extent to which those options are available, will depend on the particular circumstances of the taxpayer. The majority of options involve the Commissioner exercising her discretion and various factors will be taken into consideration to reach a decision. These factors are referred to throughout the Statement and are listed at the end.

6. Here is a summary of the relief options available:
   - Financial relief can be granted when a taxpayer cannot meet their payment obligations. The options available for financial relief are for the Commissioner to collect the amounts owing over a period of time (through an instalment arrangement), or to not collect the amount owing (that is, write off the amount), or a combination of the two options (that is, write off some of the debt and enter into an instalment arrangement for the remainder). An amount may be written off if collecting it would place the taxpayer in "serious hardship".
   - Where an amount is considered irrecoverable, the Commissioner has the discretion to write it off.
   - The Commissioner may write off amounts if collecting the amounts owing is considered to be an inefficient use of Inland Revenue's resources.
   - When a taxpayer is made bankrupt, is liquidated or their estate has been distributed, the Commissioner must write off amounts that cannot be recovered. This is not discretionary.
   - The Commissioner may permanently write off outstanding tax when the balance of the tax payable is $20 or less.
   - Certain penalties may be remitted when an event or circumstance has occurred which is beyond the taxpayer's control. The remission may be granted if the event/circumstance provides a reasonable justification that the taxpayer did not meet their obligations (for which they were given the penalty), so long as the taxpayer has corrected the failure to comply as soon as practicable. Common examples of events or circumstances are a death or illness of a family member.
   - Interest may be remitted when there has been an emergency event declared in an Order in Council which prevented the taxpayer from making the payment. Common examples of emergency events are floods or earthquakes. Before remitting interest under this ground the Commissioner must be satisfied that:
     – the taxpayer applied for the remission and paid the tax owing as soon as practicable;
     – the conditions of the Order in Council are met; and
     – the emergency event means that remitting the interest is fair.
   - Interest or certain penalties may be remitted if to do so is consistent with the Commissioner's duty to collect the highest net revenue over time.

7. This Statement applies where amounts of tax, penalty or interest were correctly imposed, but there are reasons for writing off or remitting them, or deferring their payment. Where amounts were incorrectly charged (for example, resulting from an error by Inland Revenue), they will be reversed rather than remitted or written off. Where an amount has been written off, the Commissioner may reverse the write off if the amount was written off on the basis of false or misleading information provided by the taxpayer.

8. For interest, note that section 120W of the Act provides that a taxpayer is not liable to pay interest on unpaid tax to the extent that the interest arises because the taxpayer relied on a "Commissioner's official opinion"[1], which includes opinions or official statements of the Commissioner about the taxpayer's specific situation. Section 120W does not apply to misinterpretations of what is written in an Inland Revenue publication. If section 120W applies, the interest is not written off or remitted, it is simply never imposed.

9. Finally, by way of completeness, in some cases an amount may be written off and the underlying assessment is later amended to reduce the amount of tax payable. In this case an adjustment may be required to the amount written off to ensure that an unintended credit is not created.

[1] "Commissioner's official opinion" is defined in section 3 of the Act.

Detailed discussion

Overview of the collection of tax and options for relief

10. The collection of tax is fundamental to the successful operation of the tax system. By ensuring that taxpayers are committed to paying tax on time and in full the integrity of the tax system is protected, and taxpayers understand that they will be treated fairly, consistently, impartially and in accordance with the law. This is recognised in the legislation. Section 15B(c) of the Act specifically provides that a taxpayer is obliged to pay their tax on time. In addition, section 176 of the Act sets out the general obligation that the Commissioner must maximise the recovery of outstanding tax from a taxpayer. Where tax is not paid on time, penalties and/or interest may be payable.

11. There are some situations, however, when a taxpayer has amounts owing and it may be appropriate to provide relief. These are summarised in the table below:

Grounds for relief	Obligation that can be subject to relief	Form of relief	Relevant factors (discussed in paragraph 82)	Legislative authority (sections of the Act)
Financial relief – unable to make immediate payment	Tax, interest and/or penalties	Instalment arrangement (delayed payment)	A – I (all)	Sections 177, 177A, 177B
Financial relief – serious hardship	Tax, interest and/or penalties	Write-off (no payment required)	A – I (all)	Sections 177, 177A, 177C
Unrecoverable amount	Tax, interest and/or penalties	Write-off (no payment required)	A – F	Section 177C(1)
Inefficient use of Commissioner's resources	Tax, interest and/or penalties	Write-off (no payment required)	A – E, G, H	Section 176
Bankruptcy, liquidation or the distribution of an estate	Tax, interest and/or penalties	Write-off (no payment required)	None – no discretion	Section 177C(2) and (4)
Small amounts of refunds or tax payable	Tax, interest and/or penalties	Write-off (no payment required)	C – E	Section 174AA
Event/circumstance beyond the taxpayer's control	Penalties	Remission (no payment required)	C, E - H	Section 183A
Declared emergency event	Interest	Remission (no payment required)	C, E, F	Section 183ABA
Promote compliance and collect the highest net revenue	Penalties and/or interest	Remission (no payment required)	C, E – I	Section 183D

12. For each of these grounds an explanation of the legislative criteria and when the relief is likely to be granted by the Commissioner are discussed below. The Commissioner has the discretion to grant relief for many of the situations listed above, and the exercise of this discretion will depend on a number of factors discussed in this Statement.

13. The action taken by the Commissioner for an outstanding amount may be a combination of granting one or more forms of relief outlined above, and/or collecting some or all of the amounts owed. In addition, the decision by the Commissioner may be different to the form of relief originally requested by the taxpayer. For example, a taxpayer may apply for an amount of debt to be written off as they claim that paying it will put them in serious hardship. After considering the taxpayer's circumstances the Commissioner may instead decide to collect a portion of it, enter into an instalment arrangement for a portion, and write off the remainder.

14. If, after considering the taxpayer's circumstances, the Commissioner concludes that relief under the Act is not appropriate the options available are to collect the amount owing, or if failing to do so, to apply to have the taxpayer made bankrupt (or liquidated if they are a company).

15. The care and management rules in sections 6 and 6A of the Act support this balance of, on the one hand maximising the collection of tax and, on the other hand of relieving taxpayers from their duty to pay in appropriate situations.[2] In particular:
    - Section 6 requires that the Commissioner's best endeavours are used to protect the integrity of the tax system. In carrying out this responsibility, the Commissioner is required to consider a range of factors including:
        - taxpayer perceptions of that integrity;
        - the rights of taxpayers to have their liability determined fairly, impartially, and according to law;
        - the responsibilities of taxpayers to comply with the law; and
        - ensuring the law is administered fairly, impartially, and according to law.
    - Section 6A(3) provides that it is the duty of the Commissioner to collect the highest net revenue that is practicable within the law, having regard to the resources available to the Commissioner, the importance of promoting compliance (especially voluntary compliance) by all taxpayers with the Inland Revenue Acts, and the compliance costs incurred by taxpayers. This duty requires the Commissioner to collect the highest net revenue *over time*. This means the Commissioner must consider the short and long-term implications of the various options open to her for the collection of outstanding amounts and debt relief.

Financial relief: Entering into an instalment arrangement, or writing off amounts for serious hardship

General rules

16. When a taxpayer faces financial difficulty in paying their taxes they can request that the Commissioner grant them financial relief. The relief options available under the legislation are to either have the amounts of tax, interest and/or penalties collected at a later point in time (through an instalment arrangement), or for the amounts to not be recovered by the Commissioner (that is, to apply to have the tax written off), or a combination of both options. Section 176 of the Act allows the Commissioner to not recover outstanding amounts to the extent that it would place a natural person taxpayer in serious hardship.
17. When relief is provided by way of a combination of an instalment arrangement and write off, the Commissioner will write off the agreed amount at the beginning of the instalment arrangement.
18. The words "to the extent that" in section 176 are important, and mean that the Commissioner may apportion an amount of debt so that the maximum is collected either immediately or over time and only the amount that cannot be recovered is written off. This approach ensures the Commissioner meets the obligation to maximise the recovery of outstanding tax, and her care and management obligations.
19. When an instalment arrangement is entered into, the period of the arrangement should be as short as possible, but not so short as to put the taxpayer into serious hardship. Instalment arrangements can consist of one payment or multiple payments over a period of time. If there are multiple payments being made, they can consist of equal or varied amounts, and they can be made at regular or irregular intervals. Interest will continue to apply during the term of the arrangement.
20. One of the important factors to consider for granting any form of financial relief is serious hardship. When considering serious hardship the Commissioner must follow a 2-step approach and the steps below clearly dictate that two separate decisions must be made. (The following two steps are adapted from the process set out by the judge in the case of *P v Commissioner of Inland Revenue*).[3]

    Step 1 – Is there serious hardship?

    The first step considers whether recovery of the amount owing would place the taxpayer in serious hardship. The legislation defines what "serious hardship" is.[4] After allowing for payment of outstanding tax, interest and penalties, the question the Commissioner must consider is:

    Is the taxpayer likely to have significant financial difficulties because one or more of the following factors is likely to arise after the date that the taxpayer requests financial relief? :

    a) the taxpayer or their dependant has a serious illness;

[2] Interpretation Statement IS 10/07 *Care and management of the taxes covered by the Inland Revenue Acts* provides the Commissioner's view on the application of the care and management provisions. This statement is published in *Tax Information Bulletin* Vol 22, No 10 (November 2010): 17 and available on Inland Revenue's website, www.ird.govt.nz (keyword: Interpretation statement 10/07)

[3] P v Commissioner of Inland Revenue [2015] NZHC 2293.

[4] Section 177A(2).

b) the taxpayer would likely be unable to meet minimum living expenses estimated according to normal community standards of cost and quality;

c) the taxpayer would likely be unable to meet the cost of medical treatment for an illness or injury of the taxpayer, or of their dependant;

d) the taxpayer would likely be unable to meet the cost of education for their dependant; or

e) any other factor that the Commissioner thinks relevant would likely arise.

If the answer is "yes", the test for serious hardship is met. Step 2 must be considered to determine whether the Commissioner should write off the outstanding amounts. An instalment arrangement cannot be entered into to the extent that the arrangement would place the taxpayer in serious hardship.

If the answer is "no", the test for serious hardship is not met and the outstanding amounts cannot be written off on the ground of serious hardship. The Commissioner may consider another ground or form of relief from the table in paragraph 11 (including entering into an instalment arrangement), or require that the outstanding amount be paid.

Note that in Step 1, the Commissioner must not take into account compliance or non-compliance with tax obligations when determining whether the taxpayer suffers serious hardship. Whether or not the taxpayer has met their tax obligations in the past is irrelevant for Step 1. Serious hardship also does not take into account whether the taxpayer may become bankrupt, nor does it take into account the taxpayer's ability to maintain entertainment and their social activities. It should also be noted that serious hardship can only apply to natural person taxpayers or shareholders of relief companies.[5]

Step 2 – What relief, if any, should be granted?

If the Commissioner considers that requiring the taxpayer to pay any or all of the outstanding amounts would place the person in serious hardship, the Commissioner must consider how to best deal with the debt. The options are to write off the outstanding debt (in full or in part), or allow the debt to remain and take steps to bankrupt the taxpayer.

At step 2, the Commissioner will have regard to how the debt originally arose, and the person's compliance with tax obligations as that is clearly material to whether the Commissioner should grant relief. When making this decision at step two the Commissioner will consider all of the factors, as relevant, described in paragraph 82 below.

21. The Commissioner cannot write off amounts owing (including the shortfall penalty imposed) when a taxpayer is liable to pay a shortfall penalty for an abusive tax position or evasion or a similar act, in relation to the outstanding tax.[6] In these cases the Commissioner will require payment, or may apply for the taxpayer to be put into bankruptcy or liquidation.

22. The definition of serious hardship refers to "normal community standards of cost and quality". While these standards must be considered in the context of the wider community of New Zealand, the actual expenditure of taxpayers in different parts of the country may vary. When calculating a taxpayer's minimum living expenses, the Commissioner will consider the reasonable costs of food, heating and accommodation in that taxpayer's area, based on information provided by Statistics New Zealand. However this is just a starting point and the Commissioner will have regard to expenditure incurred that is outside the norm due to a taxpayer's specific circumstances.

23. The definition of serious hardship also refers to a "dependant". Whether a person is a taxpayer's dependant will be determined on a case-by-case basis. The Commissioner will consider whether the person depends on the taxpayer for financial support, what degree of financial support is provided, and to what extent providing financial support affects the taxpayer's ability to meet minimum living expenses according to normal community standards.

24. When a payment is not made by the date it is due[7], late payment penalties may be payable and consist of the following components:

- an initial late payment penalty (firstly, a 1% penalty is applied the day after the payment was due, and secondly a 4% penalty is applied 7 days after the payment was due); and
- an incremental late payment penalty of 1% which is applied every month.

[5] Section 3(1) defines a "relief company", in relation to a taxpayer, as a company in which:
– the taxpayer owns 50% or more of the shares; or
– the taxpayer and 1 other person jointly own 50% or more of the shares; or
– the taxpayer is a shareholder-employee, and the company has five or fewer natural persons whose total voting or market value interests in the company exceed 50% and it is not a special corporate entity.

[6] Section 177C(3). Note that "liable to pay" does not mean the liability must have been assessed, imposed, or otherwise quantified. All that is required is that the criteria in section 141D or section 141E of the Act are met.

[7] A payment is due on either: the due date, or if the amount has a new due date set under section 142A, then the collection date. Section 142A applies where the Commissioner makes a new or amended assessment of tax and requires that the Commissioner fix a new date for the payment of tax. The new date must be at least 30 days after the new assessment or reassessment is issued.

25. In certain situations, some of these penalties may not be imposed. If a taxpayer anticipates they will not be able to make payments on time, they should contact Inland Revenue as soon as possible. If the application for financial relief is made before the due date and relief is granted, fewer penalties may be applied. The table below shows when a penalty will be applied (√), and when a penalty will not be applied (X), and the relevant sections of the Act:

	1% initial late payment penalty; one-off	4% initial late payment penalty; one-off	1% incremental late payment penalty; monthly
Taxpayer applies for financial relief before due date[8], and relief is granted	√ (s 139BA(1))	X (s 139BA(1))	X (s 139BA(2))
Taxpayer applies for financial relief on or after due date, and relief is granted	√ (s 139B(2)(a)(i))	√ (s 139B(2)(a)(ii))	X (s 139BA(2))
Taxpayer applies for financial relief at any time, and relief is declined	√ (s 139BA(6))	√ (s 139BA(6))	√ (s 139BA(6))
Instalment arrangement entered into	√ (s 139BA(1))	X If relief was requested before the due date (s 139BA(1)) √ If relief was requested after the due date (s 139B(2)(a)(ii))	X Not applied if the taxpayer complies with the instalment arrangement (s 139BA(4))

26. When an instalment arrangement is entered into, interest will continue to apply.

27. Before granting an application for financial relief the Commissioner will almost always require that any outstanding returns be filed. In exceptional circumstances, and on a case-by-case basis, the Commissioner will consider requests for financial relief where returns have not been filed. However, the reason for not filing the return (factors G, H and I at paragraph 82) must be taken into consideration when determining whether or not to grant relief.

28. The Commissioner may cancel an instalment arrangement if the taxpayer has provided false or misleading information, or if the taxpayer is not meeting their obligations under the instalment arrangement. When an instalment arrangement is cancelled because the taxpayer provided false or misleading information, monthly incremental penalties will be imposed retrospectively as if the instalment arrangement had not been entered into.

Process to be followed for financial relief

29. When a taxpayer feels they are in financial difficulty they can apply for financial relief. This application can be made before or after the due date for payment. It may be beneficial to apply before a due date as that may stop some penalties from applying (discussed in paragraph 25 above). If the taxpayer is applying to have tax written off, they must provide evidence to show why payment of the amount owed would place them in serious hardship (refer to paragraph 20).

30. The request for financial relief can be made verbally (by telephone or face–to–face with an Inland Revenue officer) or in writing. However, in some cases, the Commissioner may require that the application be made in writing. This may be where a taxpayer's inability to pay the outstanding tax is caused by a number of factors that require evidence in writing or when a taxpayer has related parties, such as a partnership or company, that have outstanding tax to pay. Where a taxpayer is required to put their application in writing, they may do so by post, through Inland Revenue's myIR Secure Online Services, email, fax, or delivering written notice in person to an Inland Revenue office.

31. For instalment arrangement requests in respect of outstanding GST, taxpayers can use myIR to directly request an instalment arrangement through the "GST" tab. This method of applying enables them to:
    - instantly review the forecasted instalment amounts including a breakdown of interest and penalties; and
    - receive an automatic notification of whether the instalment arrangement is accepted, or has been sent to be reviewed.

[8] As noted above, due date can mean either the date it is due, or if the amount has a new due date set under section 142A, then the collection date.

These instalment arrangements need to be a minimum of $50/week, $100/fortnight or $200/month, and the debt must be cleared within 3 years. Taxpayers who do not meet this criteria can request an instalment arrangement by the methods in paragraph 30 above.

32. Written applications for write-off will not be required when it is evident from information already available to the Commissioner that recovery would place a taxpayer in serious hardship. This may happen where a taxpayer requests relief by way of an instalment arrangement, but the information provided shows that repayment, even by way of an instalment arrangement, would place them in serious hardship. Where this is the case the Commissioner will contact the taxpayer and discuss their situation.

33. After receiving a request for financial relief the Commissioner will consider the taxpayer's financial position as at the date on which the request is made (unless the Commissioner seeks further information or makes a counter offer, as discussed in the following paragraph, and receives a response after 20 working days). The Commissioner will review the information provided as part of the application, and may also consider other information that the Department holds. All of the factors A – I in paragraph 82 are potentially relevant and will be considered by the Commissioner when deciding whether recovery of the outstanding amounts would place the taxpayer into serious hardship. As explained in the 2 step test above, an instalment arrangement can only be entered into so long as doing so does not place the taxpayer in serious hardship. If recovery of the amount owing would lead to serious hardship the Commissioner will follow the 2 step test (refer to paragraph 20) to decide whether to write off the amounts owing.

34. When considering an application for financial relief, the Commissioner may take 1 of 4 actions:[9]

- *Accept the request*

  If the request is accepted, the taxpayer will be advised in writing of:

  - the tax type(s), the relevant period(s) and any amounts of tax written off;
  - details of any instalment arrangement including the repayment amounts and frequency of payments;
  - any remaining net losses and/or excess imputation credits carried forward (see discussion at paragraph 43); and
  - the amount of any penalties or interest.

- *Seek further information from the taxpayer*

  To help the Commissioner make a decision on granting relief, a taxpayer may be asked to provide additional information including relevant financial information. If further information is requested, the taxpayer must provide that information within 20 working days (or within any longer period allowed by the Commissioner). Information received outside that timeframe will be treated as a new request for financial relief. Depending on when the original request was made and when the further information is provided this could mean additional late payment penalties are applied (see paragraph 24 above).

- *Make a counter-offer*

  The Commissioner may make a counter-offer. This may occur where, for instance, it is considered that the taxpayer can afford to make a lump-sum payment, or an arrangement involving a lump sum payment, a partial write-off and a partial instalment arrangement may be more appropriate. If a counter offer is made, the taxpayer must respond to that offer within 20 working days (or within any longer period allowed by the Commissioner). A response received outside that timeframe will be treated as a new request for financial relief.

- *Decline the taxpayer's request*

  The Commissioner may decline the taxpayer's request for various reasons, including where the Commissioner considers that:

  - the taxpayer is able to pay the outstanding tax immediately;
  - the taxpayer has not provided sufficient information to support their request;
  - agreeing to the taxpayer's request would not maximise the recovery of outstanding tax from the taxpayer;
  - the request is frivolous or the taxpayer is vexatious;
  - for instalment arrangement requests - the taxpayer has not met their obligations under a previous instalment arrangement;
  - for instalment arrangement requests - the arrangement being proposed bears little relation to the debt owed.[10]

  The taxpayer will be informed of this decision to decline the request.

[9] Section 177(3) of the Act.

[10] While the Commissioner's duty to collect highest net revenue is paramount, this is to be balanced against the care and management obligations. As was held in the case of *Russell v Commissioner of Inland Revenue* [2015] NZHC 754, to preserve the integrity of the tax system, the Commissioner may refuse to enter into an instalment arrangement with a taxpayer where the arrangement proposed bears little relation to the real debt.

35. A taxpayer who has entered into an instalment arrangement may at any point in time ask that the arrangement be renegotiated. The Commissioner may only renegotiate instalment arrangements after two years from when the arrangement was entered into. For example, it may be appropriate to renegotiate an arrangement when the taxpayer incurs new debt that they are unable to meet. Any renegotiation will be treated as if it were a new request for financial relief.[11]

36. While there is no legislative time limit for the term of an instalment arrangement, Inland Revenue's practice is that instalment arrangements are made for as short a period as possible - generally no more than 2-3 years.

37. Through the term of the instalment arrangement a taxpayer is expected to meet their current tax obligations or make a new application for financial relief if unable to meet those obligations.

Reversal of a write-off

38. The Commissioner may reverse a write off if the tax was originally written off on the basis of false or misleading information provided by the taxpayer.[12]

39. In addition, the Commissioner will reverse a write-off made on the grounds of serious hardship if the taxpayer declares bankruptcy, or is subject to bankruptcy proceedings within a year of the tax being written off. Or, in the case of a relief company, if they are liquidated or are in the course being liquidated within a year of the write-off.

40. If the Commissioner partially writes off some debt and enters into an instalment arrangement for the remainder, the Commissioner cannot reverse the write-off even if, during the term of the instalment arrangement, the taxpayer does not meet the instalment arrangement's terms.[13]

Other matters

Writing off a trust's outstanding tax

41. Trustees of a trust are personally liable for debts of the trust (including tax debts). If there is insufficient trust property to pay a trust debt, a trustee may have to pay the debt out of their own resources. When there is more than one trustee, those trustees are jointly and severally liable for the trust's tax obligations.

42. Trustees, in their capacity as natural persons, may experience serious hardship as a result of having to meet a trust's tax debt from their personal resources. The Commissioner will consider serious hardship applications from natural person trustees on a case-by-case basis and may write off tax on grounds of serious hardship when no other avenue is available for collection.

Tax losses and excess imputation credits

43. When the Commissioner writes off outstanding tax for a taxpayer (other than a partnership which is discussed in the following paragraph) who has tax losses or imputation credits carried forward from a previous year, consequential adjustments are required to those losses and imputation credits.

   - If the Commissioner writes off outstanding tax for a taxpayer who has net losses, part or all of the taxpayer's tax losses will also be extinguished. The amount extinguished is calculated by dividing the amount written off by:
     - 0.33 (if the taxpayer is not a company); or
     - 0.28 (if the taxpayer is a company)

     and reducing the tax losses by that amount.[14] This reduces any losses that can be carried forward.
   - If the Commissioner writes off outstanding tax for a taxpayer who has imputation credits carried forward from a previous year, all or part of these credits will be extinguished on a dollar-for-dollar basis.[15]
   - When a taxpayer has both tax losses and imputation credits carried forward from a previous year, the net losses will be extinguished first.[16] A taxpayer's tax losses and/or imputation credits can be extinguished even if the tax written off is not income tax.

[11] Section 177B(3),(4),(5).
[12] Section 177C(7).
[13] Section 177C(8).
[14] Section 177C(5).
[15] Section 177C(5B).
[16] Section 177C(5C).

44. When the Commissioner writes off outstanding tax for a partnership who has tax losses, the way losses are extinguished depends on the particular tax type making up the debt and the type of partnership:

- **General partnership; Income tax:** For income tax, the partnership is treated as transparent, so income is returned and any losses are carried forward by the individual partners. The Commissioner may grant relief to an individual partner by way of a write-off of their income tax debt. If that individual partner has losses, some or all of the losses will be extinguished. The amount extinguished is calculated by dividing the amount written off by 0.33. The tax position of other partners is irrelevant.
- **General partnership; GST:** For GST, the partnership itself is registered for GST, and any debt is payable by the partnership. However, the individual partners are also jointly and severally liable for any GST debt. Therefore, if a partnership cannot meet its GST liability, the debt is payable by the individual partners. If payment of the debt would place one partner in serious hardship, but not the other partners, then those other partners are liable to meet the debt. When the Commissioner decides to write off the GST debt of the partnership any losses of the individual partners will be extinguished. The partners must collectively have their losses extinguished by dividing the amount written off by 0.33. Where only some partners have losses available to extinguish, or where the losses for each individual partner is different, this will require apportionment of the total extinguished losses between the individual partners. This should be done in a way that is fair and reasonable. In the first instance this will mean extinguishing individual losses equally but where a partner has insufficient losses, the losses of other partners will be extinguished up to the maximum.[17]
- **General partnership; PAYE, RWT, NRWT, other tax types:** Losses will be extinguished depending on the liability of the partners.

  Where the legal liability to pay the outstanding tax is with the partnership (ie. the partners have no personal liability to pay the tax), none of the partners' losses can be extinguished.

  Where the partners are each liable for their proportionate share of the outstanding tax, each partner can have losses extinguished proportional to the amount of outstanding tax that they were liable for.

  Where the partners are jointly and severally liable for an amount of outstanding tax, each partner can have losses extinguished up to the total amount of tax written off (provided that the total amount extinguished from all partners does not exceed the total amount of tax written off). Note that PAYE debt is owed by the individual partners on a joint and several basis.
- **Limited partnerships:** Limited partnerships comprise of general partners (responsible for the management of the partnership) and limited partners. General partners are liable for the partnership debt and the principles applied for the extinguishment of losses are the same as described in the bullet points above. Limited partners who take part in the management of the limited partnership are liable, to the same extent as a general partner, if, at the time that the debt was incurred:
  - the limited partner took part in the management of the limited partnership; and
  - Inland Revenue was aware the limited partner took part in the management of the limited partnership; and
  - Inland Revenue believed on reasonable grounds that the limited partner was a general partner.

  A limited partner who does not take part in the management of the partnership is not liable for the partnership debt.

45. The Commissioner needs to know the correct value of losses or imputation credits when making the adjustments required after writing off outstanding tax. So a taxpayer will almost always be required to file all outstanding tax returns before their application for a write-off will be considered.

Irrecoverable amount

46. In addition to the grounds discussed above, the Commissioner may also write off outstanding tax, interest and/or penalties that cannot be recovered.

47. This ground may apply in combination with another ground (for instance, an amount may be irrecoverable because the taxpayer is in serious hardship, or an amount is irrecoverable because the administrative resource needed to recover it is considered high and so would be an inefficient use of those resources). However, it may also apply in isolation. Whether an amount is considered to be irrecoverable is to be determined on a case-by-case basis. Factors A - G in paragraph 82 will be relevant in deciding whether to write off the amount owing.

[17] The maximum is the amount set out in section 177C(5) of the Act, calculated for partnerships as the total amount written off divided by 0.33.

Voluntary administration

48. During the voluntary administration process as provided in the Companies Act 1993 the Commissioner may enter into a deed of company arrangement and as a result the Commissioner may receive some payments from the taxpayer. Amounts that are irrecoverable will not be written off under the Tax Administration Act until the company has been released from debts as a result of the process followed under the Companies Act.

No asset procedure

49. The "no asset procedure" is a one-off process that provides a fresh start to natural persons. It is administered by the New Zealand Insolvency and Trustee Service and is available as an alternative to bankruptcy for those people who have insufficient income and no assets left to sell to repay debts from $1,000 up to $47,000.

50. Unless the Commissioner has cause to ask the Official Assignee to reject or overturn the no asset procedure, any tax owed by a taxpayer who is subject to the procedure is effectively frozen and the Commissioner cannot take any recovery action.

51. Once a taxpayer has been released from debts covered by a no asset procedure, the Commissioner will then write off the balance of the outstanding tax on the basis that it is irrecoverable.

Inefficient use of resources

52. The Commissioner has limited resources to undertake what can sometimes be a lengthy process to collect outstanding amounts. Consistent with the obligations under sections 6(1) and 6A(3), she will not recover outstanding amounts if the recovery of that outstanding tax, interest or penalties would be an inefficient use of her limited administrative resources.[18] If the Commissioner makes a decision under this ground, the tax will be written off.

53. However, a taxpayer cannot request that outstanding amounts be written off simply because they consider that collection would be an inefficient use of the Commissioner's resources. It is for the Commissioner to determine how Inland Revenue's resources are allocated. These decisions will be made by Inland Revenue staff with the authorised level of authority. The seniority of position that is required to write off amounts under this ground is an internal process and will depend on the amount being written off.

54. When making a decision whether to write off outstanding amounts under this ground, the Commissioner must take into account factors A – E, H and I in paragraph 82.

55. In considering this ground for writing off tax there will be some instances where the Commissioner will pursue amounts owing even though the cost of collection may be higher than the outstanding tax. In these cases recovery action may still be considered appropriate if it is consistent with the Commissioner's obligations under sections 6 and 6A, including protecting the integrity of the tax system, promoting compliance and collecting over time the highest net revenue.[19]

Bankruptcy, liquidation or the distribution of an estate

56. The Commissioner must write off amounts that cannot be recovered because of bankruptcy or liquidation.[20] When a taxpayer is adjudicated bankrupt they will be issued with a new IRD number. The Commissioner will write off outstanding tax[21] under the bankrupt's previous IRD number upon receiving advice from the Official Assignee that a dividend is unlikely or a final report or notice that the taxpayer is discharged from bankruptcy.

57. Similarly, when a company is liquidated the Commissioner will write off outstanding tax that cannot be recovered upon receiving a final report or advice from the liquidator that there will be no dividend to Inland Revenue.

58. When an estate has been distributed, the Commissioner must write off any outstanding tax that cannot be recovered upon receiving confirmation from the administrator that the estate has been properly distributed.[22]

59. The Commissioner may only reinstate tax that has been written off if:
    - by operation of law, additional funds are received in respect of a taxpayer after that taxpayer has become bankrupt or has been liquidated; or
    - additional funds due to a taxpayer's estate are discovered after that taxpayer's estate has been distributed.[23]

[18] Section 176(2)(a).
[19] Russell v Commissioner of Inland Revenue [2015] NZHC 754.
[20] Section 177C(2).
[21] With the exception of child support amounts owing.
[22] Section 177C(2).
[23] Section 177C(4).

60. This is the case notwithstanding section 177C(3) (discussed above at paragraph 20). Where a taxpayer had been liable to pay a shortfall penalty for evasion or an abusive tax position and the taxpayer is now liquidated or bankrupt, despite section 177C(3), the amount owing will be written off under section 177C(2).

61. If an instalment arrangement has been entered into and the taxpayer then becomes bankrupt or liquidated, the outstanding amount under the instalment arrangement must be included in Inland Revenue's proof of debt to the Official Assignee.[24]

Small amounts of refunds or tax payable

62. The Commissioner may permanently write off outstanding tax when the balance of the tax payable is $20 or less.[25]

63. If it is established later that a taxpayer's assessment or interest calculation was wrong, the Commissioner must amend the taxpayer's account to show the correct tax payable. Any earlier write-off made may also be adjusted to the correct amount of tax payable.

64. Factors C - F in paragraph 82 will be relevant in deciding whether to write off the amount owing.

Remission

65. The purposes of the penalty provisions in the Act are:[26]

- to encourage taxpayers to comply voluntarily with their tax obligations and to co-operate with the department; and
- to ensure that penalties for breaches of tax obligations are imposed impartially and consistently; and
- to sanction non-compliance with tax obligations effectively and at a level that is proportionate to the seriousness of the breach.

And the purposes of charging taxpayers interest are to:[27]

- compensate the Commissioner for the loss of use of money; and
- to encourage taxpayers to pay the correct amount of tax on time.

66. However, Inland Revenue recognises that charging interest or penalising a taxpayer for an unintended non-compliant action may be counterproductive and may actually reduce voluntary compliance. So in certain situations the Commissioner may remit interest and/or penalties.

67. It is important to treat taxpayers requesting a remission of penalties and interest fairly and consistently when compared to those in a similar tax position. For example, while allowing a penalty to remain could affect that taxpayer's future compliance, a lenient remission practice may also mean that compliant taxpayers, who have met their obligations on time, may be less likely to do so in the future.

68. The following sections discuss three circumstances where penalties and/or interest may be remitted.

Event/circumstance beyond the taxpayer's control

69. Where a taxpayer has not complied with a tax obligation and as a result has been charged a penalty, the Commissioner may, in certain cases, remit that penalty. Section 183A allows the Commissioner to remit these penalties for "reasonable causes" explained in paragraph 71 below.

70. A taxpayer can request, under this section, for the following penalties to be remitted:

- a late filing penalty;
- a non-electronic filing penalty;
- initial and incremental late payment penalties;
- imputation penalty tax;
- Māori authority distribution penalty tax;
- a shortfall penalty imposed by section 141AA for failing to make a deduction from a payment to a non-resident contractor;
- a civil penalty imposed by section 215 of the KiwiSaver Act 2006 for employers who fail to provide information; or
- a penalty for not paying an employer monthly schedule amount imposed by section 141ED.

(Section 183A does not apply to interest. Nor does it apply to shortfall penalties, other than those imposed by sections 141AA and 141ED).

[24] Section 177CA.
[25] Section 174AA.
[26] Section 139.
[27] Section 120A.

71. Before the Commissioner can remit a penalty under this section, she must be satisfied of 3 factors:

- *The penalty arose as the result of an event or a circumstance beyond the taxpayer's control*

  The Act provides that an "event or circumstance" may include an accident, disaster, illness, or emotional or mental distress. However, the Commissioner also has the discretion to consider other circumstances that are not specifically included in the legislation.

  An "event or circumstance" does not include a taxpayer's financial position. Requests for financial relief are dealt with under sections 176 and 177. See paragraphs 16 - 37 for more information.

  Penalties cannot be remitted under this ground if they arose as a result of an event or circumstance that is caused by an act or omission by an agent of the taxpayer. However, remission can be considered if the act or omission was caused by an event or circumstance that was beyond the control of the agent, could not have been anticipated, and the effect could not reasonably have been avoided. The term "agent" is not defined in the Act. For practical purposes, the Commissioner considers an agent is someone who has been given due authority by the taxpayer to act on their behalf in relation to their general, or specific, tax matters. It could include tax agents, intermediaries or other nominated persons.

  The Commissioner will also consider whether the agent's default could have been avoided by compliance with accepted standards of business organisation and professional conduct.

- *There is reasonable justification for the breach of the relevant tax laws*

  The Commissioner will look at the reason that the taxpayer did not meet their obligations. Whether there is a reasonable justification will be determined objectively. Before an event or circumstance can be considered to provide a taxpayer with reasonable justification for failing to meet their obligations:

  – the event or circumstance relied on by the taxpayer must be identified;

  – it must be determined whether the event or circumstance was beyond the control of the taxpayer; and

  – consideration must be given to whether the event or circumstance provided the taxpayer with reasonable justification.

- *The taxpayer corrected the failure to comply as soon as practicable*

  The taxpayer must have filed the relevant return and paid any outstanding core tax as soon as it was feasible or realistic after the event or circumstance that caused the breach.

72. In deciding whether remission is appropriate, the Commissioner will consider the factors above along with any other information that the Commissioner considers relevant in assessing the application. The Commissioner may request supporting information if necessary.

Declared emergency event

73. Section 183ABA allows the Commissioner to remit interest charged when an emergency event physically prevents a taxpayer from making a tax payment.

74. Before the Commissioner can remit interest under this section, she must be satisfied of the following requirements:

- *An emergency event has occurred*

  Section 183ABA applies only in the circumstances of an emergency event. An emergency event is an event that meets the definition of "emergency" in section 4 of the Civil Defence Emergency Management Act 2002 and is declared to be an emergency event by Order in Council for the purposes of section 183ABA.[28]

  An emergency event can be natural or otherwise and can include an earthquake, tsunami, technological failure, riot or a warlike act.

- *The emergency event physically prevented a taxpayer from making a tax payment*

  Taxpayers had been unable to comply with their tax obligations due to the emergency event significantly affecting them in the following ways:

  – they were unable to access their records, for example, through evacuation or destruction of a home or business; or

  – they were unable to make payments because they were physically prevented from doing so, for example, extensive infrastructure damage that prevented any local movements, disruption of postal deliveries or damage to phone lines.

[28] Orders in Council are legislative instruments and can be found on the Inland Revenue website (www.ird.govt.nz) or the Parliamentary Counsel Office website (www.legislation.govt.nz).

- *The taxpayer made the payment of tax and applied for remission of interest as soon as practicable*

  A taxpayer who is seeking remission must have paid the tax and applied for the remission as soon as practicable (that is, as soon as it is feasible or realistic) after the event. This will depend on the circumstances of each case.

- *The taxpayer is a member of the specified class of persons*

  The Order in Council that declares the emergency event will have set out a class of people to whom remission is available.

- *The Order in Council is valid; it has not expired or been revoked*

  Amounts may be remitted up until the expiry date set out in the Order in Council.

- *The Commissioner is satisfied that the effect on the taxpayer of the occurrence of the emergency event makes the remission equitable*

  Relief may be granted under section 183ABA if the effect of the emergency event on the taxpayer's personal situation means that it is fair that the interest be remitted.

75. The taxpayer must also provide supporting information if requested by the Commissioner.

Remission consistent with collection of the highest net revenue over time

76. Section 183D allows the Commissioner to remit interest and/or penalties if it is consistent with the Commissioner's duty to collect the highest net revenue over time.

77. Under this provision the Commissioner may remit:
    - a late filing penalty;
    - a non-electronic filing penalty;
    - initial and incremental late payment penalties;
    - a shortfall penalty imposed by section 141AA for failing to make a deduction from a payment to a non-resident contractor;
    - a civil penalty imposed by section 215 of the Kiwisaver Act 2006 for employers who fail to provide information;
    - a penalty for not paying an employer monthly schedule amount imposed by section 141ED; and/or
    - interest under part 7.

    (Section 183D does not apply to shortfall penalties other than those imposed by sections 141AA and 141ED)

78. Before the Commissioner can remit a penalty or interest under this section, she must consider:
    - *Whether remitting the interest and/or penalties is consistent with the Commissioner's duty to collect over time the highest net revenue that is practicable within the law*

      The Commissioner must consider whether, and the extent to which, remitting penalties and/or interest can promote compliance, especially voluntary compliance, and thereby result in a higher collection of revenue over time.

    - *How the imposition of penalties and interest is used in promoting compliance, especially voluntary compliance*

      As noted in paragraph 65 above, encouraging voluntary compliance is one of the key purposes of the penalty rules. The Commissioner recognises that pursuing the collection of penalties in some circumstances will not be consistent with those aims, for example, when a penalty may have been imposed due to:

      – a genuine error; or

      – a one-off situation.

      Each application for remission will be considered on the merits of the case.

      Interest will only be remitted in limited circumstances. The test of whether or not interest should be remitted focuses on whether charging the particular taxpayer interest is inconsistent with promoting compliance of all taxpayers. In making this decision, the Commissioner will be mindful of the purpose of charging interest. That is, to compensate the Commissioner for the loss of use of the money and also to encourage taxpayers to pay the correct amount of tax on time.

79. When considering remission under section 183D, the taxpayer's financial situation cannot be taken into account.[29] This means the taxpayer's ability (or inability) to pay the tax owing is not a factor when deciding whether to grant remission.

[29] Section 183D(3) of t ct.

80. In deciding whether remission is appropriate, the Commissioner will consider the following factors:
    - Why did the taxpayer pay or file late, or not file electronically?
    - Whether the non-compliant action was the result of a genuine oversight or a one-off situation:
        - Requests for remission because of a genuine oversight or a one-off situation apply to penalties only. Inland Revenue will not remit interest in these cases as it is compensation to the Commissioner for the loss of the use of the money over time.
        - If interest is charged because of an error or default by a third party, the Commissioner considers the taxpayer should look to that third party for compensation.
    - Was there an error in an Inland Revenue publication that has resulted in the taxpayer incurring the penalty or interest? If the taxpayer relies on incorrect information contained in an Inland Revenue publication, it may be unreasonable for the Commissioner to impose a penalty or charge interest.
    - Any other information that Inland Revenue considers relevant in assessing the application. In particular, how will the remission contribute to the collection of the highest net revenue over time and otherwise promote voluntary compliance by all taxpayers?
81. The Commissioner may request supporting information if necessary.

Factors for the Commissioner to consider

82. In deciding whether to grant relief, the Commissioner will consider whether the legislative criteria for each form of relief are met, as covered in the earlier sections of this Statement. Of particular importance is the obligation on the Commissioner to maximise the recovery of outstanding amounts.[30] In addition, the Commissioner may take into account other, more general, factors. These are explained below. They are not listed in order of importance and the factors that apply and the weighting that they are given will depend on the particular case. The table at paragraph 11 summarises which factors are relevant for the various grounds for relief.

[30] Section 176 of the Act.

A. *Taxpayer's financial position*

The Commissioner may consider the taxpayer's ability to pay the outstanding amount, either immediately or in the future. This may, depending on the circumstances, include consideration of:

- income and expenses (including income and expenditure for relationship property, family and spousal income where appropriate);
- assets and liabilities including asset valuations;
- a 12-month projection of cash-flow (including whether they are due to receive any sums of money in the near future (for instance, from the sale of a property, or from an inheritance));
- a statement of financial performance (a profit and loss statement);
- a statement of financial position (a balance sheet);
- a list of debtors and creditors, including how much is owed to or by the taxpayer; and
- any vested interest held in another entity (such as a trust).

A comparison of the taxpayer's financial position will be made to Statistics New Zealand's Household expenditure survey which sets out average expenses. This comparison is simply a starting point, and the Commissioner will consider other expenditure that is incurred due to the taxpayer's personal circumstances.

The taxpayer's financial position **cannot** be taken into account when considering whether to grant relief under sections 183A or 183D.

B. *Options available to the Commissioner*

The Commissioner has a duty to maximise the recovery of outstanding tax from a taxpayer and so is obliged to compare the value of the likely recovery from accepting a taxpayer's proposal to other viable options for recovery. The options available are:

- collection of the amount owing in full;
- entering into an instalment arrangement;
- writing off amounts;
- remitting amounts;
- applying to have the taxpayer made bankrupt or liquidated. These options are administered by the Insolvency and Trustee service, and may result in some payment being made to Inland Revenue.

In some cases, it is clear which option will maximise recovery. In other cases, there may be options that could yield similar returns. Accordingly, it is necessary to determine which option, or combination of options, will maximise recovery.

C. *Integrity of the tax system*

One of the core obligations imposed under the Act requires Inland Revenue officers to use their best endeavours to protect the integrity of the tax system.[31]

The "integrity of the tax system" is defined in section 6 of the Act. Three points of particular relevance are discussed below:

- *Taxpayers' perception of integrity* – the Commissioner must ensure that granting relief to some taxpayers is not viewed as unjust by others in the taxpaying community. This requires the Commissioner to act legally and to provide consistent treatment.

  The Commissioner will be mindful of the taxpayer's expenditure, in particular spending on unnecessary goods or services. Taxpayers requesting that relief be granted should not be allowed to maintain lifestyles with high amounts of discretionary spending when either the spending is unnecessary or there are reasonable alternatives available involving lower expenditure. For example, it is unlikely that the Commissioner would agree to writing off outstanding tax while the taxpayer continues to pay private school fees.

- *The responsibilities of taxpayers to comply with the law* – Where there has been a deliberate failure by a taxpayer to comply with their tax obligations and where recovery is uncertain or is likely to result only in a relatively minor proportion of the overall outstanding tax being recovered, the Commissioner may initiate enforcement proceedings to secure the wider interests identified by the legislation.

[31] Section 6 of the Act.

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- *The responsibilities of those administering the law to do so fairly, impartially, and according to law* – Tax obligations are imposed under the law and are intended to apply to all relevant taxpayers. Taxpayers should be treated consistently.

  Where a taxpayer's offer for payment of all or part of the outstanding amounts (such as an instalment arrangement) would yield more than bankruptcy or liquidation action, the Commissioner is likely to consider this favourably. However, before making a decision to accept the offer, the Commissioner will weigh this up against the other factors. Any amount not recoverable under the agreement will be written off at the time the agreement is entered into.

D. Resources available to the Commissioner

When making any decision the Commissioner must consider the resources required to carry out that action and the resources that are available. The Commissioner must then make a decision of whether the use of resources is justified and in making this decision the relative importance of other factors will be considered.

E. Importance of promoting compliance

This factor is one of the Commissioner's care and management considerations, and comprises a range of considerations. Voluntary compliance underpins tax administration.

F. Taxpayer's reasons for failure to pay

The Commissioner will consider the circumstances leading to the taxpayer having outstanding amounts, the causes of those circumstances and to what extent the taxpayer contributed to, or failed to mitigate, those circumstances.

G. Taxpayer's compliance history

The Commissioner will consider a taxpayer's whole history of compliance. In particular, the Commissioner will consider the taxpayer's history with regards to filing tax returns and payments of tax. The outcomes of previous relief granted (such as whether the taxpayer met their obligations under previous instalment arrangements, or whether the taxpayer changed their actions to prevent recurrent financial hardship) will also be considered.

H. The taxpayer's co-operation

The Commissioner will consider the nature and extent of the taxpayer's co-operation and negotiating stance; and the speed with which the taxpayer provided requested information as well as the quality of that information.

Taxpayers who are co-operative and forthcoming with information save Inland Revenue time and resource in verifying information, allow constructive discussions to take place, and allow the tax system to be administered more efficiently. In comparison, taxpayers who are frivolous and/or vexatious result in Inland Revenue investing more resource than is reasonable.

I. Steps taken to avoid similar situation in future

The Commissioner will consider whether any steps have been, or will be, taken by the taxpayer to prevent the situation from recurring in the future. This may involve improved budgeting, selling assets, adjusting lifestyle factors, or any other relevant steps taken.

Reviewing a decision of the Commissioner

Section 138E(1)(e)(iv) provides that there is no statutory right of challenge where the Commissioner has made a decision to grant relief, decline to grant relief, or to cancel relief under sections 176, 177, 177A, 177B, 177C, 183A and 183D.

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

If a taxpayer is not satisfied with the level of service they have received from Inland Revenue, they can find more information about the Inland Revenue Complaints Management Service at http://www.ird.govt.nz/how-to/complaints-and-disputes/complaints-process/ or phone 0800 274 138 (Monday to Friday between 8am and 5pm).

This Standard Practice Statement is signed on 22 August 2018.

Rob Wells
Manager – Technical Standards

APPENDIX – Relevant provisions of legislation

Tax administration act 1994

The following sections of the Tax Administration Act 1994 are particularly relevant to the relief provisions. For the most recent version of the Act, and any other provisions, see www.legislation.govt.nz

Section 176 Recovery of tax by Commissioner

(1) The Commissioner must maximise the recovery of outstanding tax from a taxpayer.

(2) Despite subsection (1), the Commissioner may not recover outstanding tax to the extent that—

(a) recovery is an inefficient use of the Commissioner's resources; or

(b) recovery would place a taxpayer, being a natural person, in serious hardship.

(3) Despite subsection (2)(b), the Commissioner may take steps preparatory to, or necessary to, bankrupt the taxpayer, including debt proceedings in the District Court or the High Court.

Section 177 Taxpayer may request financial relief

(1) A taxpayer, or a person on a taxpayer's behalf, requests financial relief by either—

(a) making a claim stating why recovery of the taxpayer's outstanding tax or a relief company's outstanding tax would place the taxpayer, being a natural person, in serious hardship; or

(b) requesting to enter into an instalment arrangement with the Commissioner.

(1B) For the purposes of this section, the Commissioner must consider the taxpayer's financial position at the date on which the request for financial relief is made.

(2) The Commissioner may require a taxpayer, or a person on a taxpayer's behalf, to request financial relief under subsection (1)(a) by notice.

(3) Upon receiving a request, the Commissioner may—

(a) accept the taxpayer's request; or

(b) seek further information from the taxpayer; or

(c) make a counter offer; or

(d) decline the taxpayer's request.

(4) A taxpayer has 20 working days, or a longer period allowed by the Commissioner, to provide the information sought or to respond to a counter offer.

(5) If the Commissioner receives information or a response from a taxpayer outside the time period allowed under subsection (4), the receipt of the information or the response will be treated as a new request for financial relief.

Section 177A How to apply serious hardship provisions

(1) Subsections (2), (3) and (4) provide the rules for the Commissioner to decide (the decision) whether, -

(a) for the purposes of section 176, recovery of outstanding tax would place a taxpayer, being a natural person, in serious hardship:

(b) for the purposes of section 177, the Commissioner may accept the taxpayer's request for financial relief on the basis of a claim that recovery of the taxpayer's outstanding tax or a relief company's outstanding tax would place the taxpayer, being a natural person, in serious hardship:

(c) for the purposes of section 177B, an instalment arrangement entered into by a taxpayer or a relief company would place the taxpayer, being a natural person, in serious hardship:

(d) for the purposes of section 177C, recovery of the outstanding tax would place the taxpayer, being a natural person, in serious hardship.

(2) The Commissioner makes a decision under this section by determining whether financial information, after allowing for payment of a relevant amount of outstanding tax, and subject to subsections (3) and (4), shows that the taxpayer would, after the request under section 177 (the **request**), likely have significant financial difficulties because, after the request,—

(a) the taxpayer or their dependant has a serious illness:

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(b) the taxpayer would likely be unable to meet—

(i) minimum living expenses estimated according to normal community standards of cost and quality:

(ii) the cost of medical treatment for an illness or injury of the taxpayer, or of their dependant:

(iii) the cost of education for their dependant:

(c) other factors that the Commissioner thinks relevant would likely arise.

(3) Compliance with, and non-compliance with, tax obligations must not be considered by the Commissioner when making a decision under this section.

(4) The Commissioner must use only financial information that the Commissioner has at the date on which the decision is made.

Section 177B Instalment arrangements

(1) The Commissioner must not enter into an instalment arrangement with a taxpayer or a relief company to the extent that the arrangement would place the taxpayer, being a natural person, in serious hardship.

(2) The Commissioner may decline to enter into an instalment arrangement if—

(a) to do so would not maximise the recovery of outstanding tax from the taxpayer; or

(b) the Commissioner considers that the taxpayer is in a position to pay all of the outstanding tax immediately; or

(c) the taxpayer is being frivolous or vexatious; or

(d) the taxpayer has not met their obligations under a previous instalment arrangement.

(3) A taxpayer may renegotiate an instalment arrangement at any time.

(4) The Commissioner may renegotiate an instalment arrangement at any time after the end of 2 years from the date on which the instalment arrangement was entered.

(5) The renegotiation of an instalment arrangement is treated as if it were a new request for financial relief.

(6) The Commissioner may cancel an instalment arrangement if—

(a) it was entered into on the basis of false or misleading information provided by the taxpayer; or

(b) the taxpayer is not meeting their obligations under the arrangement.

(7) Despite sections LA 6(2) and LH 2(6) of the Income Tax Act 2007, a taxpayer with an instalment arrangement who is meeting their obligations under it may choose to have an amount of refundable tax credit remaining for a tax year paid to them rather than used under the ordering rules set out in those sections.

Section 177C Write-off of tax by Commissioner

(1) The Commissioner may write off outstanding tax that cannot be recovered.

(1BA) The Commissioner may use, as a ground for deciding whether or not to write off the outstanding tax of a taxpayer or of a relief company, the basis that recovery of the outstanding tax would place the taxpayer, being a natural person, in serious hardship. The Commissioner is not required to write off the outstanding tax if the ground exists.

(1B) The Commissioner may write off an amount of outstanding tax to the extent to which the amount—

(a) is outstanding from the 2008–09 tax year; and

(b) is tax payable under section MF 5(2) or MF 6(2) of the Income Tax Act 2007, or is otherwise the result of WFF tax credit overpayment or overcrediting; and

(c) is outstanding due to amendments to the family scheme made by the Taxation (Personal Tax Cuts, Annual Rates, and Remedial Matters) Act 2008.

(1C) The Commissioner must write off an amount, not exceeding $100, of outstanding tax to the extent to which the amount—

(a) is outstanding from the 2008–09 tax year; and

(b) is tax payable under section MF 5(2) or MF 6(2) of the Income Tax Act 2007, or is otherwise the result of WFF tax credit overpayment or overcrediting.

(1D) The Commissioner must write off an amount, not exceeding $30, of outstanding tax to the extent to which the amount—

(a) is outstanding from the 2010–11 tax year; and

(b) is tax payable under section MF 5(2) or MF 6(2) of the Income Tax Act 2007, or is otherwise the result of WFF tax credit overpayment or overcrediting.

(2) The Commissioner must write off outstanding tax that cannot be recovered in the following situations:

(a) bankruptcy:

(b) liquidation:

(c) a taxpayer's estate has been distributed.

(3) Despite subsection (1), the Commissioner must not write off outstanding tax (inclusive of any shortfall penalties), if a taxpayer is liable to pay, in relation to the outstanding tax, a shortfall penalty for an abusive tax position or evasion or a similar act.

(4) Despite subsection (2), the Commissioner may reinstate all or part of the outstanding tax written off if the Commissioner receives, by operation of law, additional funds in respect of a taxpayer after the taxpayer becomes bankrupt, is liquidated or if additional funds due to the taxpayer's estate are discovered after the taxpayer's estate has been distributed.

(5) If the Commissioner writes off outstanding tax for a taxpayer who has a tax loss, the Commissioner must extinguish all or part of the taxpayer's tax loss, by—

(a) dividing the amount written off by 0.33 and reducing the tax loss by that amount, if the taxpayer is not a company; or

(b) dividing the amount written off by 0.28 and reducing the tax loss by that amount, if the taxpayer is a company.

(5B) If the Commissioner writes off outstanding tax for a taxpayer who has a tax credit carried forward under section LE 3 of the Income Tax Act 2007, the Commissioner must extinguish an amount of the tax credit on a one-for-one basis.

(5C) If a taxpayer has both a tax loss to which subsection (5) applies and a tax credit to which subsection (5B) applies, the Commissioner must extinguish the tax loss before extinguishing the tax credit.

(6) For the purpose of subsection (5), the tax loss that may be extinguished is the tax loss of the taxpayer at the time at which the outstanding tax is written off and the Commissioner may use a figure for that tax loss based on the most recent return of income furnished by the taxpayer.

(7) The Commissioner may reverse a write-off if—

(a) outstanding tax is written off on the grounds of serious hardship, and the taxpayer for whom the debt was written off is a natural person who—

(i) declares bankruptcy within a year of the outstanding tax being written off; or

(ii) is subject to bankruptcy proceedings brought by a creditor within a year of the outstanding tax being written off; or

(b) outstanding tax is written off on the grounds of serious hardship, and the taxpayer for whom the debt was written off is a relief company which, within a year of the outstanding tax being written off, is, or is in the course of being, liquidated; or

(c) the outstanding tax was written off due to false or misleading information provided by the taxpayer.

(8) If the Commissioner enters into an instalment arrangement that provides for some outstanding tax to be written off, the Commissioner may not reverse the write-off even if, during the term of the instalment arrangement, the taxpayer does not meet the instalment arrangement's terms.

Section 183A Remission for reasonable cause

(1) This section applies to—

(a) a late filing penalty:

(b) a non-electronic filing penalty:

(c) a late payment penalty:

(d) imputation penalty tax imposed by section 140B:

(e) [Repealed]

(f) Maori authority distribution penalty tax imposed by section 140CB:

(g) a shortfall penalty imposed by section 141AA:

(h) a civil penalty imposed under section 215 of the KiwiSaver Act 2006:

(i) a penalty for not paying employer monthly schedule amount imposed by section 141ED.

(1A) The Commissioner may remit the penalty if the Commissioner is satisfied that—

(a) a penalty to which this section applies arises as a result of an event or circumstance beyond the control of a taxpayer; and

(b) as a consequence of that event or circumstance the taxpayer has a reasonable justification or excuse for not furnishing the tax return or an employer monthly schedule, or not furnishing an employer monthly schedule in a prescribed electronic format, or not paying the tax on time; and

(c) the taxpayer corrected the failure to comply as soon as practicable.

(2) Without limiting the Commissioner's discretion under subsection (1), an event or circumstance may include—

(a) an accident or a disaster; or

(b) illness or emotional or mental distress.

(3) An event or circumstance does not include—

(a) an act or omission of an agent of a taxpayer, unless the Commissioner is satisfied that the act or omission was caused by an event or circumstance beyond the control of the agent—

(i) that could not have been anticipated; and

(ii) the effect of which could not have been avoided by compliance with accepted standards of business organisation and professional conduct; or

(b) a taxpayer's financial position.

Section 183ABA Remission in circumstances of emergency event

(1) This section applies for a taxpayer if—

(a) an emergency event, declared in an Order in Council under this section, physically prevents the taxpayer from making a payment required by a tax law on or before the due date for the payment; and

(b) the taxpayer is charged with interest under Part 7 for failing to make the payment by the due date; and

(c) the taxpayer is a member of a class of persons to whom a remission under this section is available, if such a class of persons is described in the Order in Council declaring the emergency event.

(2) The taxpayer may ask the Commissioner to remit the interest.

(3) The Commissioner may remit the interest if the Commissioner is satisfied that—

(a) it is equitable that the interest be remitted; and

(b) the taxpayer asked for the relief as soon as practicable; and

(c) the taxpayer made the payment as soon as practicable.

(4) The Governor-General may from time to time by Order in Council—

(a) declare an event that meets the requirements of paragraphs (a) and (b) of the definition of emergency in section 4 of the Civil Defence Emergency Management Act 2002, to be an emergency event:

(b) describe a class or classes of persons to whom a remission under this section is available in relation to the emergency event.

(5) An Order in Council (the **order**) made under subsection (4) or this subsection—

(a) may relate to an event that occurred after the commencement of this Act and before the commencement of the order:

(b) expires, if not renewed under paragraph (c), after—

(i) the period given in the order, if such a period is given; or

(ii) if no such period is given, 6 months from the promulgation of the order:

(c) may be renewed or replaced from time to time by an Order in Council made before or after the date on which the order would otherwise expire.

Section 183D Remission consistent with collection of highest net revenue over time

(1) The Commissioner may remit—

(a) a late filing penalty; and

(aa) a non-electronic filing penalty; and

(b) a late payment penalty; and

(bb) a shortfall penalty imposed by section 141AA; and

(bc) a civil penalty imposed under section 215 of the KiwiSaver Act 2006; and

(bd) a penalty for not paying employer monthly schedule amount imposed by section 141ED; and

(c) interest under Part 7—

payable by a taxpayer if the Commissioner is satisfied that the remission is consistent with the Commissioner's duty to collect over time the highest net revenue that is practicable within the law.

(2) In the application of this section, the Commissioner must have regard to the importance of the penalty, and interest under Part 7, in promoting compliance, especially voluntary compliance, by all taxpayers and other persons with the Inland Revenue Acts.

(3) The Commissioner must not consider a taxpayer's financial position when applying this section.

Section 3 – Legislative definitions - Selected relevant definitions are below:

Commissioner's official opinion—

(a) means, for a taxpayer,—

(i) an opinion of the Commissioner concerning the tax affairs of the taxpayer communicated by the Commissioner after all information relevant to forming the opinion has been provided to the Commissioner, if that information is correct:

(ii) a finalised official statement of the Commissioner notifying the taxpayer, if it specifically applies to the taxpayer's situation:

(b) does not include a private binding ruling

Relief company means, in relation to a taxpayer, a company in which—

(a) the taxpayer owns 50% or more of the shares:

(b) the taxpayer and 1 other person jointly own 50% or more of the shares:

(c) the taxpayer is a shareholder-employee, and the company satisfies paragraphs (a) and (c) of the definition of **close company** in section YA 1 of the Income Tax Act 2007.

Other relevant legislative provisions

In the Tax Administration Act 1994:

- Section 15B(c)
- Section 120A
- Section 120W
- Section 139B
- Section 139BA
- Section 141AA
- Section 141D
- Section 141E
- Section 141ED
- Section 142A
- Section 174AA

Civil Defence Emergency Management Act 2002 – Section 4 - Definition of "emergency".

Companies Act 1993 – voluntary administration provisions.

Kiwisaver Act 2006 – section 215

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 18/14: GST treatment of fees that suppliers charge customers for using a credit or debit card

This item will be of interest to suppliers who charge their customers a fee for using a credit or debit card to pay for goods or services. The GST treatment of credit or debit card fees almost always follows the GST treatment of the underlying goods or services.

Question

What is the GST treatment of the fee that suppliers charge their customers for using a credit or debit card to purchase goods or services?

Answer

Where suppliers charge their customers a fee for using a credit or debit card to purchase goods or services, that fee will form part of the consideration for the goods or services being supplied where:

- the supplier supplies the payment facility directly to the customer;
- the supplier arranges for an agent to supply the payment facility to the customer on the supplier's behalf; or
- the supplier contracts with a third party to supply a payment facility to the customer.

The fee will have the same GST treatment as the goods or services being supplied. If the goods or services are taxable, output tax must be returned on the amount of the fee.

Key terms

Payment facility: a service for processing credit or debit card transactions.

Payment facility provider: a company (often a third party) appointed by a supplier to process credit and debit card payments on the supplier's behalf.

Key provisions

Sections 3, 14 and 60(1) of the Goods and Services Tax Act 1985

Explanation

Background

1. All legislative references are to the Goods and Services Tax Act 1985.
2. Suppliers that accept payment by credit or debit card may sometimes impose a fee on their customers to recover the cost of providing credit or debit card payment facilities. Sometimes the supplier charges this fee directly to the customer and sometimes a third party or an agent of the supplier charges the fee to the customer.
3. This Question We've Been Asked (QWBA) considers the GST treatment of these fees. The issue is whether the fee forms part of the consideration for the goods or services being supplied (so there is a single composite supply of the goods or services and the payment facility) or whether the fee is a separate supply of a payment facility. This QWBA therefore expands on the analysis in Interpretation Statement "IS 17/03: Goods and services tax – single supply or multiple supplies" *Tax Information Bulletin* Vol 29, No 4 (May 2017):102.
4. Inland Revenue has previously published items on the GST treatment of credit card fees charged by suppliers: see *Agents Answers* No 142 (December 2011); *Business Tax Update* No 26 (December 2011); *Large Enterprises Update* No 18 (February 2012); *Business Tax Update* No 4 (July 2016). These items concluded that the fee was part of the underlying supply of goods or services and should therefore be treated in the same way as the underlying supply for GST purposes. This means that if the underlying supply is subject to GST, the fee will be too. This QWBA is consistent with the position taken in these items.

Analysis

5. This QWBA explains how to determine the GST treatment of credit or debit card fees charged by suppliers to customers. This involves:
   - Identifying who is actually making the supply of the payment facility. In some cases, the supplier may provide the customer with the payment facility directly. In other cases, the supplier may engage an agent or third-party to provide the customer with the payment facility.
   - Determining whether a supplier has made one composite supply or multiple separate supplies.

Identifying who makes the supply

6. In some cases, a supplier may provide the payment facility directly to the customer. In other cases, a supplier may contract with a third party or an agent to provide a credit or debit card payment facility to the supplier's customer. It is therefore necessary to determine who makes the supply of the payment facility to the customer.

7. The approach of the New Zealand courts is to consider the true nature of the legal arrangements actually entered into and carried out by the supplier and the recipient in light of the surrounding circumstances. The contractual arrangements between the parties must be examined to determine who is supplying what to whom: *Marac Life Assurance Ltd v CIR* (1986) 8 NZTC 5,086 (CA); *CIR v Databank Systems Ltd* (1990) 12 NZTC 7,227 (PC); *Auckland Institute of Studies v CIR* (2002) 20 NZTC 17,685 (HC) and *Wilson & Horton Ltd v CIR* (1995) 17 NZTC 12,325 (CA).

8. In *Auckland Institute* the High Court stated that it is necessary to "examine the supply from the point of view of the consumer" by considering "the true and substantial nature of the consideration given for the payment by the consumer".

9. Overseas courts have considered consumer perspectives where customers use credit or debit cards to purchase goods or services. In *HMRC v Debenhams Retail plc* [2005] EWCA Civ 892, the English Court of Appeal observed that where the customer uses a credit or debit card to pay for the goods, they must be taken to appreciate that the purchase of goods in this way will give rise to rights and duties with the credit card company or issuing bank. The general understanding of the public is that once the supplier has accepted payment by way of the credit or debit card, the customer has discharged their obligations to the business and they will need to pay the credit card company for the goods or services purchased. The court noted that ordinary customers would also be taken to be aware that some businesses levy a small additional charge on their customers to cover the cost to them of their customers' use of some cards. The *Debenhams* decision is discussed in more detail from [28].

10. In Case C-276/09 *Everything Everywhere Ltd* v *HMRC* [2010] ECJ (2 December 2010), and Case C-607/14 *Bookit Ltd* v *HMRC* [2016] ECJ (26 May 2016), the Court of Justice of the European Union noted that customers expect suppliers to make available an infrastructure enabling them to pay for the goods or services they purchase. It also stated that access to the payment facility was not an end in itself for customers who can have no interest in accessing that infrastructure independently of purchasing the goods or services. In both cases, the court concluded that there was a single composite supply of the goods or services and the payment handling services.

A single composite supply or multiple supplies

11. Where the supplier is supplying both the payment facility and the goods or services it is necessary to determine whether the supplier is making two separate supplies or a single composite supply.

12. IS 17/03 sets out the Commissioner's approach for determining whether a supplier has made one composite supply or multiple separate supplies. The approach involves identifying the multiple elements being supplied and deciding whether it is reasonable for those elements to be treated as a single composite supply or separate supplies. The Commissioner's approach is to ask three key questions:
   - What is the true and substantial nature of what is supplied to the recipient (the customer) for their payment?
     - This question is determined objectively, by examining what is supplied **from the recipient's perspective**.
     - The fact that elements could have been supplied separately does not mean those elements should be severed from the rest of the supply.
     - Simply because a single price is charged for multiple elements does not determine whether one or more than one supply is made. It is the actual supply made to the recipient that must be considered and not how the supply is invoiced or charged to the recipient.

- What are the relationships between the elements supplied?
  - This question involves determining whether one element is merely ancillary or incidental to, or a necessary or integral part of, any other element being supplied in the transaction.
  - Factors that indicate whether an element is ancillary or incidental to, or a necessary or an integral part of, a dominant element include whether the element is:
    - not an aim in itself; instead, the element facilitates, contributes to, or enables the supply of the dominant element;
    - a means of better enjoying the dominant element;
    - an optional extra and is not in any real or substantial sense part of the consideration for which a payment is made.
- Is it reasonable to sever the elements into separate supplies?
  - This question requires taking an overall view and looking for the essential purpose of the transaction.
  - An element should not be artificially split from what, from an economic point of view, is a single supply.

Applying the law to the facts

13. A supplier can supply a payment facility to a customer in a number of ways.

The supplier supplies the payment facility directly to the customer

14. In this scenario, the supplier has acquired the payment facility from the payment facility provider. The supplier then supplies the payment facility directly to the customer (for example, by presenting the customer with an EFTPOS terminal at the point of sale).

15. From the customer's perspective, the supplier is supplying them with goods or services for consideration. In addition, the supplier is supplying the customer with the payment facility. The additional fee charged to the customer is consideration for the supply of the payment facility. Applying the principles from IS 17/03, there is a single composite supply of the goods or services and the payment facility.

16. Overseas courts have also held that a supplier who supplies a payment facility directly to a customer is making a single composite supply of the goods or services and the payment facility: see *Waverley Council v FC of T* 2009 ATC 10-095 (AAT) and *Everything Everywhere Ltd*.

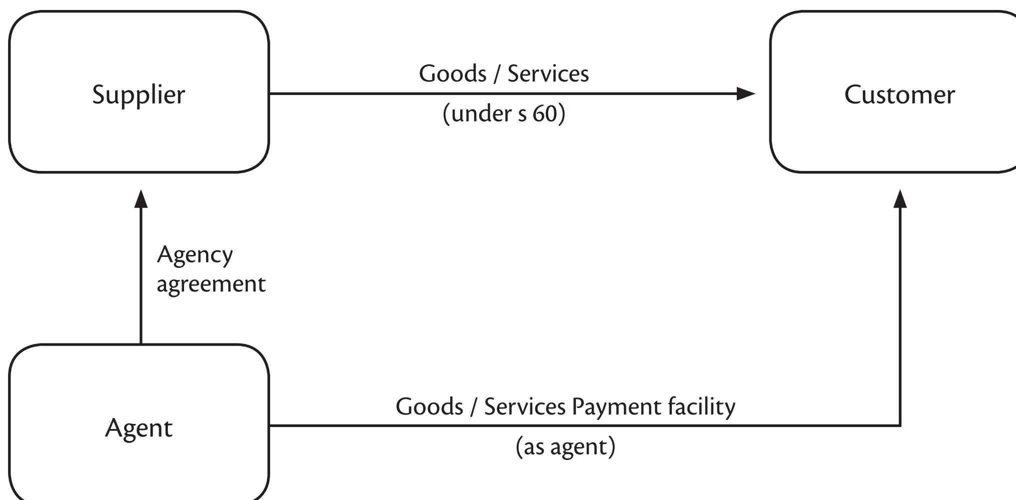
Example 1 – Meal at a restaurant

Li takes her parents out for a meal at a restaurant. After they finish the meal, Li goes to pay the bill using her credit card. The waiter informs Li there is a 2% surcharge for using a credit card.

The true nature of the legal arrangement is that the restaurant has made a supply of multiple elements, namely the meal and the credit card facility. Viewing the arrangement between Li and the restaurant from Li's perspective, the dominant supply is the supply of the meal in a restaurant. For Li, the ability to use the credit card is not an aim in itself. Instead, the facility to pay by credit card is ancillary to the dominant supply of the meal, in the sense that it enables the supply to occur.

There is therefore a single composite taxable supply of a meal, with the surcharge being part of the consideration for that supply. This means the restaurant is required to return GST output tax on the total consideration.

An agent supplies the payment facility to the customer on the supplier's behalf



17. In this scenario, a supplier enters into an agency agreement with an agent. The agent agrees to supply the goods or services to the customer as agent for the supplier. The agent also provides the supplier's customers with access to a payment facility on behalf of the supplier.

18. Unless the parties have agreed otherwise, where an agent makes a supply of goods or services to a recipient for and on behalf of their principal, that supply is deemed to be made by the principal to the recipient: s 60(1). Therefore, if a supplier's agent provides goods or services and a payment facility to a customer for and on behalf of the supplier, the supply of those goods or services and the payment facility will be deemed to be made by the supplier to their customer. The position is the same if the agent only provides the payment facility on behalf of the supplier and not the goods or services.

19. Applying the principles from IS 17/03, in both cases there will be a single composite supply of the goods or services and the payment facility.

20. *Bookit Ltd* supports the view that from the customer's perspective there is a single composite supply. In this decision, the Court of Justice of the European Union concluded that the supply of the card handling services by a booking agent was part of the supply of the tickets by the cinema (as principal).

Example 2 – Ticketing agency

Wiremu purchases a theatre ticket for $50 from Book Now Ltd. Because Wiremu uses his credit card to pay for the ticket, Book Now charges him a $2 card-handling fee. Book Now has an agency agreement with the theatre. Under this agreement, Book Now sells the tickets on behalf of the theatre as its agent; agrees to provide purchasers with a credit or debit card payment facility; and is permitted to charge purchasers a $2 fee for using the payment facility. In addition, the theatre pays Book Now an agency fee.

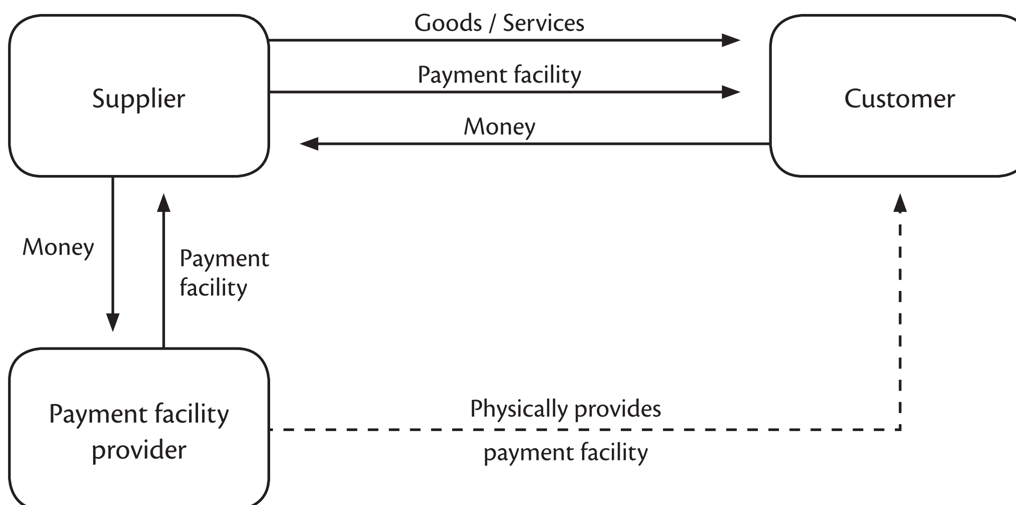
Book Now is supplying Wiremu with the ticket (to be redeemed for entertainment services) and the payment facility as agent for the theatre. Therefore, the theatre (as principal) and not Book Now (as agent) is treated as supplying the ticket and the payment facility to Wiremu (s 60(1)).

The issue is whether this supply is a single composite supply or two separate supplies.

The true nature of the legal arrangement is for the supply of multiple elements, namely the ticket and the payment facility. Viewing the arrangement between Wiremu and Book Now (as the theatre's agent) from Wiremu's perspective, the dominant supply is the supply of the ticket. The payment facility is ancillary to that supply. Accessing the payment facility is not an aim in itself for Wiremu; it only facilitates the supply of the ticket in the sense of enabling Wiremu to pay for it.

There is therefore a single composite taxable supply of a ticket with the card handling fee being part of the consideration for that supply. As a consequence, all the elements of the supply under the agreement are subject to GST.

The supplier contracts with a third party to supply a payment facility to the customer



21. Section 60(1) will not apply where a payment facility provider supplies goods or services **to the supplier** under a contract between them, and the supplier then subsequently supplies those goods or services to the customer. In this situation there are two separate supplies: a supply between the payment facility provider and the supplier and a supply between the supplier and the customer of the payment facility: see *CIR v Databank Systems Ltd* (1989) 11 NZTC 6,093 (CA) and *Databank* (PC).

22. Where there is no agency arrangement, *Databank* is authority for the principle that where a supplier contracts for a third party to supply it with goods or services that the supplier then uses to make an overall supply to the customer, two separate supplies are made: the supply by the third party to the supplier and the supply by the supplier to its customers. In such cases, the third party does not make a supply to the customer. Therefore, where a supplier contracts with a third party to provide a payment facility to the supplier's customers, the supplier – not the third party – will be treated as supplying the payment facility to the customers where the customers contract only with the supplier.

23. In *Databank*, Databank provided banks with computer data-processing services. The services involved processing cheques, crediting and debiting the banks' customers' accounts, and general account maintenance. The issue was whether Databank supplied GST-exempt "financial services" to the banks under s 3 of the Act or GST standard-rated taxable computing services.

24. The Privy Council recognised that the banks used Databank's computing services to supply financial services to customers. However, it held that the computing services Databank supplied did not satisfy the definition of "financial services". Delivering the majority judgment, Lord Templeman rejected the relevance of s 60 and noted that it does not address the supply of agency services by an agent **to its principal** for consideration; rather, s 60 addresses supplies made by an agent **for and on behalf of** its principal. The terms of the agreements between Databank and the banks meant Databank was supplying its services to the banks, not to the banks' customers. The agreements showed that the banks supplied the financial services to the customers. Consequently, there were two supplies: the supply of computing services by Databank to the banks and the supply of financial services by the banks to their customers.

25. This approach is consistent with *Auckland Institute.* In *Auckland Institute*, the taxpayer was an educational institute which provided tuition to overseas students. The institute contracted with a subsidiary to provide pre-arrival services to the students. The pre-arrival services included arranging the payment of tuition fees to the institute and completing enrolment and application forms for other services the institute provided. Under the institute's contract with the subsidiary, the institute agreed the subsidiary was permitted to charge an "overseas assistance fee" for the pre-arrival services. The students only contracted with the institute. The subsidiary's overseas assistance fee was not separately charged to the students; instead, the students paid the institute a global fee for all the services they received.

26. The High Court stated that the issue was to determine the true and substantial nature of the consideration given for the payment by the customer. This involved examining the contractual agreements between the students, the institute and its subsidiary to identify what the customer sought and was given.

27. The High Court held that the pre-arrival services were provided to facilitate the students undertaking a course of study. Viewing the arrangements between the students and the institute from the customer's (the student's) perspective, the dominant element of the transaction was the provision of tuition. That was the true and substantial nature of the consideration given for the payment. The pre-arrival services were necessary, but incidental to that tuition. Therefore, the services the institute provided to students through its subsidiary comprised a single supply of tuition services by the institute to the students.

28. The English Court of Appeal's decision in *Debenhams* is consistent with *Databank* and *Auckland Institute*. In *Debenhams*, the court held that there was no separate supply of card-handling services by a third-party payment processor to Debenhams' customers. Debenhams had contracted with the payment processor, but the customers had not, so the third-party payment processor could not be treated as making a supply of card-handling services to Debenhams' customers. Consequently, Debenhams was treated as supplying the card-handling services to the customers. This is consistent with *Auckland Institute* because, from the customer's perspective, the customer paid the fees as consideration for the supply of the payment facility.

Example 3 – Paying online using a payment facility provider

Andrew has a monthly plan with his mobile phone company Ember. His $100 mobile phone bill is due for payment. He goes to the "Pay Online" page of Ember's website. Before making the $100 payment, Andrew is advised that paying online with a debit or credit card will incur an additional 2% processing fee that will appear on his next statement as a separate transaction. Andrew proceeds and is redirected to a third-party payment facility provider. He provides his debit card details and his payment is processed.

Ember has entered into a contract with the third-party payment facility provider to process its customers' credit and debit card payments.

Ember, not the third-party payment facility provider, has supplied the payment facility to Andrew. A contract exists between Ember and the third-party payment facility provider, but no contract exists between Andrew and the third-party payment facility provider. Andrew has only contracted with Ember. This is made clear in the terms and conditions of Andrew's monthly plan and the invoice that shows that Ember is charging the fee to Andrew.

The true nature of the legal arrangement is that Ember has supplied Andrew with multiple elements – mobile phone services and a payment facility – with each element itemised and charged for separately. Viewing the arrangement between Andrew and Ember from Andrew's perspective, the dominant supply is the supply of mobile phone services, even though he is paying a fee as consideration for using the payment facility. Andrew's ability to use his debit card is not an aim in itself. The payment facility is ancillary to the dominant supply of the mobile phone services in that it enables that supply to occur.

Consequently, the card processing fee is part of the $102 of consideration for a single composite supply of mobile phone services. It is not consideration for a separate supply. Therefore, Ember should return GST on the phone charges and the processing fee when calculating GST on the supply of mobile phone services.

Example 4 – Buying furniture on an interest-free deal

Mariana's favourite furniture store, IKEO is advertising 12 months' interest-free credit on purchases over $1,000 made using a Wow credit card. Wow credit cards are issued by a finance company. Mariana decides to purchase a $2,500 lounge suite using her Wow credit card, taking advantage of the 12 months' interest-free deal. The consultant tells Mariana there will be a 2% credit card fee on her purchase ($50) and an advance fee ($35). The advance fee is a one-off fee the Wow credit card company charges to cover the costs of processing the interest-free credit offer.

The consultant provides Mariana with a sales voucher from the Wow credit card company that she asks Mariana to sign. The voucher states that Wow is advancing Mariana $2,550 for the furniture purchase and $35 for the advance fee at 0% per annum for 12 months.

IKEO is not a party to the agreement between Mariana and Wow. Wow is not a party to the agreement between Mariana and IKEO. Based on the legal arrangements, there are two separate supplies for GST purposes. IKEO is supplying furniture to Mariana and Wow is supplying finance to Mariana.

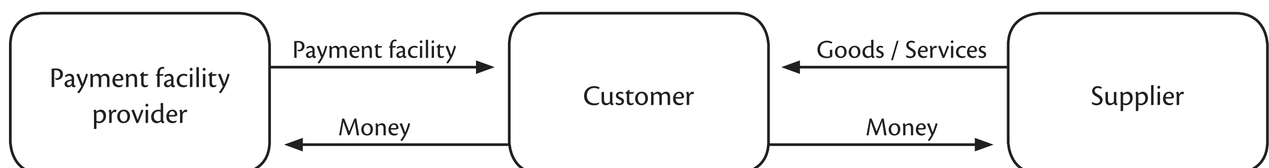
The $50 credit card fee relates to the supply of furniture by IKEO. It is charged and invoiced by IKEO as consideration for Mariana using the credit card payment facility IKEO offers to its customers. The credit card fee is calculated by reference to the amount of the furniture purchase. The $35 advance fee relates to the supply of the interest-free credit. The advance fee is charged by Wow under its credit contract with Mariana and is identified as consideration for the processing services required to supply the credit.

The $50 credit card fee is part of the consideration for a single composite supply of furniture by IKEO. It is not consideration for a separate supply of the payment facility by IKEO. The payment facility is ancillary to the dominant supply of the furniture. Accessing the credit card payment facility is not an aim in itself for Mariana; instead, it only facilitates the supply of the furniture in the sense of enabling Mariana to pay for it. Therefore, there is a single, composite, taxable supply of furniture, so all the elements of the supply under the agreement (that is, the furniture and the credit card fee) are subject to GST.

The $35 advance fee is part of the consideration for a single composite supply of interest-free credit by Wow. It is not consideration for a separate supply of processing services by Wow. The true nature of the legal arrangement is for the supply of multiple elements, namely the interest-free credit and the documenting and processing services. Viewing the arrangement between Mariana and Wow from Mariana's perspective, the dominant supply is the supply of the interest-free credit. The processing services are ancillary to the dominant supply of the interest-free credit. Obtaining the processing services is not an aim in itself for Mariana. She has obtained these services only as a necessary pre-condition for securing the interest-free credit. Therefore, there is a single, composite supply of interest-free credit, which is an exempt supply of "financial services". As a result, the processing service element of that supply is also exempt from GST.

A third party supplies the payment facility directly to the customer

29. Depending on the contractual arrangements, it may be that instead of the supplier supplying the payment facility to the customer, a third party supplies the payment facility to the customer under a separate contract. In these cases, the contract between the supplier and the customer will only be for the goods or services. A separate contract will occur between the third party providing the payment facility and the customer.



30. If it can be established that there is a separate supply of a payment facility to a customer by a third party, the GST treatment of that separate supply will not be determined by the GST treatment of the supply of goods or services by the supplier. This is because the supply of the payment facility is a separate supply between different parties. The GST treatment of the supply of the payment facility will need to be determined by considering the nature of what has actually been supplied.

31. Even where the supply of the payment facility is a separate supply, the Commissioner's view is that it will not be an exempt supply of a "financial service" if the payment facility only provides access to the payment network and facilitates the exchange of information between the card issuer, the acquiring bank and the supplier.

32. The provision of such a payment facility does not amount to the "arranging" of "financial services" under s 3(1)(l), because whether the credit or debit card is charged or settlement occurs, depends on the card issuer's overriding decision. The payment facility provider's role on these facts is limited to transmitting and recording the information that is relied on by the card issuer in making these decisions.

Example 5 – a third party supplies the payment facility directly to the customer

Lucas has set up an online shop called Cheap Feet to sell his animal print socks. Customers select socks and add them to an online shopping cart. When it comes time to pay for their order, customers are automatically directed to an online payment website called PAYBO.

PAYBO is an online payment platform that provides access to the payment network and facilitates the exchange of information between the card issuer, the acquiring bank and Cheap Feet. It does not debit or credit the customer's account nor does it provide a guarantee to Cheap Feet that settlement will occur.

Customers using this service must agree to the PAYBO terms and conditions, which includes permitting PAYBO to charge a 2% credit card surcharge on top of the purchase price. That charge is paid directly to PAYBO.

The true nature of the legal arrangements is that there are two separate supplies being made. Cheap Feet has made a supply of goods (the socks) to the customer. PAYBO has made a supply of credit card payment facilities to the customer. Cheap Feet is not a party to the agreement between the customer and PAYBO.

The supply of goods from Cheap Feet to the customer is subject to GST at the standard rate. PAYBO will need to determine how to treat the supply of payment facilities to the customer by analysing the services provided under its contract with the customer.

Summary

33. The relevant legal principles for determining the GST treatment of fees that suppliers charge customers for using a credit or debit card to purchase goods or services are:
    - To identify what has been supplied, consider the true nature of the legal arrangements actually entered into and carried out by the supplier and the recipient in light of the surrounding circumstances: *see Marac Life Assurance.*
    - Where two (or more) persons are involved in supplying goods or services to a customer, contractual arrangements between **all** the parties need to be examined to determine who is supplying what to whom: see *Databank* (PC) and *Auckland Institute*.
    - It is necessary to examine the supply from the point of view of the consumer (the customer) by considering the true and substantial nature of the consideration given for the payment by the consumer: see *Auckland Institute.*
    - If an agent makes a supply of a payment facility to the supplier's customer, then the supplier will be treated as making the supply of the payment facility to the customer: see s 60(1) and *Databank*.
    - Where a supplier contracts with a third-party to provide a payment facility to the supplier's customers, the supplier and not the third-party will be treated as supplying the payment facility to the customers: see *Databank; Auckland Institute* and *Debenhams.*

References

Subject references

credit and debit cards
GST
multiple supplies
payment facility
single supply

Legislative references

Goods and Services Tax Act 1985, ss 3, 14, 60

Case references

Auckland Institute of Studies Ltd v CIR (2002) 20 NZTC 17,685 (HC)

Case C-607/14 *Bookit Ltd v HMRC* [2016] ECJ (26 May 2016)

CIR v Databank Systems Ltd (1989) 11 NZTC 6,093 (CA)

CIR v Databank Systems Ltd (1990) 12 NZTC 7,227 (PC)

Case C-276/09 *Everything Everywhere Ltd v HMRC* [2010] ECJ (2 December 2010) *HMRC v Debenhams Retail plc* [2005] EWCA Civ 892

Marac Life Assurance Ltd v CIR (1986) 8 NZTC 5,086 (CA)

Waverley Council v FC of T 2009 ATC 10-095 (AAT)

Wilson & Horton Ltd v CIR (1995) 17 NZTC 12,325 (CA)

Other references

"GST Treatment of credit card surcharges/fees charged by some retailers" *Business Tax Update* No 74 (July 2016)

"GST Treatment of credit card surcharges/fees charged by some retailers" *Large Enterprises Update* No 18 (February 2012)

"GST Treatment of credit card surcharges/fees charged by some retailers" *Agents Answers* No 142 (December 2011)

"GST Treatment of credit card surcharges/fees charged by some retailers" *Business Tax Update* No 26 (December 2011)

"IS 17/03: Goods and services tax – single supply or multiple supplies" *Tax Information Bulletin* Vol 29, No 4 (May 2017): 102

"Question 49" *Public Information Bulletin* No 158 (November 1986): 8

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.

Special Determination S60: Spreading of income and expenditure under deferred payment arrangement

This Determination may be cited as *Special Determination S60: Spreading of income and expenditure under Deferred Payment Arrangement*.

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

1.1 In 2017, a company (the Company) and related entities entered into an agreement (the Agreement) to sell certain of its operations to a third party purchaser (the Purchaser). The Agreement provided for part of the consideration to be paid on a contingent and deferred basis (the Deferred Payments).

1.2 For the Company to be liquidated in a solvent liquidation, the Company assigned its entitlement to receive the Deferred Payments to a Creditors' Trust, as bare trustee for all of the creditors of the Company, including the Applicants. The assignment was made in partial satisfaction of existing debts owed by the Company to its creditors.

1.3 The contingent future Deferred Payments was valued at the time of the sale at $18.76 million (the Valuation). The Valuation used an expected value methodology that had been agreed with the Commissioner.

1.4 The right of the Applicants to receive the Deferred Payments is a "financial arrangement" as defined in s EW 3 (the Deferred Payment Arrangement). This Determination prescribes the method to be used by the Applicants to spread any income under that financial arrangement.

2. Reference

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

3. Scope of determination

3.1 This Determination applies to the Applicants in relation to the Deferred Payment Arrangement. Under the Deferred Payment Arrangement, the Company assigned its rights to future cashflows to the Applicants, in partial satisfaction of existing debts owed by the Company to the Applicants.

3.2 The Deferred Payment Arrangement is part of a wider arrangement between the parties, which is the subject of Private Ruling BR Prv 18/65 (issued on 17 August 2018). This Determination is made subject to the continued application of that Private Ruling.

3.3 For the purposes of this Determination, it is assumed that the Valuation is the market value of the Deferred Payments on the date of assignment.

4. Principle

4.1 The Deferred Payment Arrangement is a "financial arrangement" as defined in s EW 3, and is not an "excepted financial arrangement" under s EW 5.

4.2 Under s EW 12, the Applicants are required to use a spreading method to calculate an amount of income or expenditure for each income year over the term of the Deferred Payment Arrangement, other than the income year in which a base price adjustment (BPA) is required (s EW 13(1)). The Applicants must use the method set out in this Determination to spread any income in relation to the Deferred Payment Arrangement.

4.3 Under s EW 29, a BPA will be required in the income year when the final payment is due under the Deferred Payment Arrangement (currently expected to be 2021). The Applicants will not have any expenditure under the Deferred Payment Arrangement in any income year prior to the income year in which a BPA is required.

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.
- **Applicants** means the creditors that applied for Private Ruling BR Prv 18/65 and this Determination.
- **Proportionate Share** means the percentage proportionate share for each Applicant as set out in the final beneficiary schedule provided by the Company's liquidators.

6. Method

6.1 In each income year prior to the year in which a BPA is required, each Applicant is only required to recognise income under the Deferred Payment Arrangement to the extent that:

- the Applicant receives a payment from the Purchaser in that income year; and
- the cumulative amounts of all of the Deferred Payments received by the Applicant in that income year and all preceding income years exceeds the Applicant's Proportionate Share of the Valuation.

6.2 In the income year in which the final payment is due under the Deferred Payment Arrangement, each Applicant will be required to undertake a BPA calculation. Private Ruling BR Prv 18/65 confirms the treatment of the outcome of the BPA calculation.

7. Example

These examples illustrate the application of the method set out in this Determination and are based on an Applicant having a 25% Proportionate Share of the $18.76 million Valuation (that is, $4.69 million).

Example A

This example is based on the Applicant receiving:

- $4 million in year 1 of the Deferred Payment Arrangement;
- $1 million in year 2 of the Deferred Payment Arrangement;
- $0 in year 3 of the Deferred Payment Arrangement (which is also the year in which a BPA is required).

The Applicant will recognise income from the Deferred Payment Arrangement as follows:

	Year 1	**Year 2**	**Year 3**
Cumulative cash received	$4 million	$5 million	$5 million
Income recognised in income year	$0	$0.31 million	$0 (under the BPA calculation)

Example B

This example is based on the Applicant receiving:

- $2 million in year 1 of the Deferred Payment Arrangement;
- $1 million in year 2 of the Deferred Payment Arrangement;
- $0 in year 3 of the Deferred Payment Arrangement (which is also the year in which a BPA is required).

The Applicant will recognise income from the Deferred Payment Arrangement as follows:

	Year 1	**Year 2**	**Year 3**
Cumulative Cash received	$2 million	$3 million	$3 million
Income recognised in income year	$0	$0	–$1.69 million (expenditure under the BPA calculation)

This Determination is signed by me on the 17th day of August 2018.

Fiona Heiford
Manager, Taxpayer Rulings

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.

The Authority confirmed the assumption that all matters at issue are to be determined in one trial because that would normally be the most expeditious and efficient manner for dealing with a proceeding

Case	XXX [2018] NZTRA 05
Decision date	11 July 2018
Act(s)	District Court Rules 2014 r 10.21
Keywords	Splitting trial, separate issues, questions decided in advance of substantive trial

Summary

This is an interlocutory application by the disputant for an order to have two questions decided in advance of the substantive trial. The application arises by the disputant challenging the Commissioner of Inland Revenue's ("the Commissioner") assessments of income tax and GST on a number of grounds. The Authority held that the disputant did not discharge the burden to show that it is appropriate for either question to be heard in a separate trial.

Facts

The disputant was the sole director of AB Limited ("the Company") from 30 September 2004 until it was placed into liquidation on [X] December 2009. It was removed from the Companies Register on [Y] August 2015.

At the time that the Company went into liquidation, it had a self-assessed GST liability of $3.8 million. The disputant does not seek to challenge those self-assessments.

On 28 March 2014, the Commissioner reassessed the Company's income tax for the years ended 31 March 2008 and 31 March 2009 together with certain GST periods. The Company's total tax liability at that date was assessed at $13,032,717.82 including interest, shortfall penalties, late filing penalties and late payment penalties.

On 31 March 2014, the Commissioner made the disputable decision that the disputant is liable as agent for the income tax and GST liabilities of the Company under s HD 15 of the Income Tax Act 2007 and s 61 of the Goods and Services Tax Act 1985 respectively.

Decision

The application for a separate trial in respect of both Question One and Question Two is dismissed.

Splitting of the Trial

The Authority confirmed the assumption that all matters at issue are to be determined in one trial because that would normally be the most expeditious and efficient manner for dealing with a proceeding (*Clear Communications Ltd v Telecom Corporation of New Zealand Ltd* (1998) 12 PRNZ 333 at 334 and *Turners and Growers Ltd v Zespri Group Ltd* HC Auckland CIV-2009-404-4392, 5 May 2010 at [11]). The burden to displace the presumption rests on the party seeking to split the trial. The burden has been variously described as "not insignificant", "moderate" and "heavy" (*Haden v Attorney General* (2011) 22 PRNZ 1 (HC) at [46], *KPMG New Zealand v Gemmell* HC Auckland CIV-2018-404-4288, 27 March 2009 at [20] and *Clear Communications* at 335).

The Authority has a broad discretion in granting an order under r 10.21 of the District Court Rules. The most important questions to be addressed before granting an application for a split trial are as follows (*Haden v Attorney General* at [50]):

> Will there be difficult demarcation questions between those issues to be addressed at the first trial and those left for the second?
>
> Will the separate question bring the proceedings to an end?
>
> What potential time saving does the separate question offer?
>
> How will appeals be dealt with?
>
> Are there any other practical considerations tending one way or another?

Question One

The Authority used the questions as a framework for its consideration and held that:

> Question One could be determined as a discreet issue, however the determination of this Question would not bring the proceedings to an end and will only settle the scope of the evidence to be given at the substantive hearing which will affect the length and cost of the trial;
>
> The time required to hear the additional evidence and submissions is estimated at only 4 days, and if Question One is held in the disputant's favour, there will be no time saved in the substantive trial. Rather, further lead time and cost will have been added in relation to the separate trial.
>
> No right of appeal exists from an Authorities decision on an interlocutory application. Therefore, there would be no right of appeal from the Authority's decision on either Question One or Question Two. It would be necessary for the substantive hearing to be completed before any appeal can be filed in the High Court. This will cause difficulties including further discovery being required, duplication of time by counsel, witnesses needing to be recalled, and availability of the Authority. The possibility of an appeal is a significant consideration which the Authority held that the facts tend strongly against the granting of this application.

On Question One the Authority held that the disputant did not discharged the burden of showing that it is appropriate to direct that a separate trial be held.

Question Two

The same difficulties addressed above in Question One also applied to Question Two and the burden was not discharged.

High Court confirms that judicial review is discretionary and it is inappropriate for the Court to exercise its discretion to grant relief where it could serve no purpose or have practical effect

Case	*Brian Cyril Rowell v District Court at Blenheim and Attorney General* [2018] NZHC 1863
Decision date	25 July 2018
Act(s)	Judicial Review Procedure Act 2016; Tax Administration Act 1994 s 92B; Criminal Procedure Act
Keywords	Bias, genuine mistake, procedural error, relief

Summary

Brian Cyril Rowell ("Mr Rowell") judicially reviewed Zohrab's J decision to decline to recuse himself from hearing Mr Rowell's criminal charges. The basis for the judicial review was that Zohrab J showed bias in favour of the Prosecutor against Mr Rowell when he "provided a privately-distributed minute" to the prosecutor to use in New Zealand Law Society complaint proceedings. The Attorney-General opposed the application on the basis that Mr Rowell did not establish actual or apparent bias and that the judicial review was moot. There would be no practical effect of granting relief in this case as the charges against Mr Rowell have been transferred to the Wellington District Court and Zohrab J will not preside over any further proceedings involving Mr Rowell.

The Court found for the Attorney-General and the judicial review application was dismissed.

Impact

This Judgment confirms that it is procedurally wrong to have information placed before a decision-maker, without the information being disclosed to all parties. However, where it was a genuine mistake and not with intent to secretly keep information from the defendant, it does not give rise to an appearance of bias of the Judge.

The Judgment also confirms that relief in judicial review proceedings is discretionary and it is inappropriate for the Court to exercise its discretion to grant relief where it could serve no useful purpose or have practical effect.

Facts

Mr Rowell is facing 31 criminal charges (to be heard in the Wellington District Court) of aiding and abetting his companies to provide false Goods and Services Tax (GST) returns. His application to have the charges dismissed was heard and dismissed by Zohrab J in the Blenheim District Court on 10 February 2016.

During the hearing Mr Rowell became aware the prosecution's summary of facts had been given to Zohrab J at his request prior to the hearing. While Mr Rowell received a copy of the summary of facts, he was unaware Zohrab J received a copy.

On 15 April 2016, Mr Rowell complained to the New Zealand Law Society that the prosecutor had not told him that the summary of facts was handed up to Zohrab J.

On 6 May 2016, Zohrab J issued a minute in which he explained how the Court came to be in possession of the summary of facts.

Due to an error by a Deputy Registrar, the minute was not sent to Mr Rowell. The minute was sent to the prosecutor and used by the prosecutor in the defence of the Mr Rowell's complaint to the Law Society.

Mr Rowell then applied for Zohrab J to recuse himself on the ground of bias, which was declined on 28 June 2016.

On 10 August 2017, Mr Rowell's criminal trial was transferred from Blenheim District to the Wellington District court by consent.

On 13 December 2017, Mr Rowell applied for judicial review seeking to have the 28 June 2016 decision quashed.

Decision

Issue 1: Was there actual or apparent bias?

The Court noted and applied the relevant principles for recusal that were settled by the Supreme Court in *Saxmere Co Ltd v Wool Board Disestablishment Co Ltd* [2009] NZSC 72, [2010] 1 NZLR 35 (at [3]–[4], [20], [81] and [86]; recalled on the merits by *Saxmere Co Ltd v Wool Board Disestablishment Co Ltd* (No 2) [2009] NZSC 122, [2010] 1 NZLR 76 at [4]). A Judge should recuse himself or herself on the basis of apparent bias if a fair-minded and properly-informed lay observer might reasonably apprehend that the Judge might not bring an impartial mind to the resolution of the question which the Judge is to decide. This involves two stages:

(a) First, the Judge must identify the circumstances that may lead the Judge to decide a case other than on its merits.

(b) Second, the party alleging apparent bias must also articulate a logical connection between the matter complained of and the feared deviation from impartiality.

The Court identified two key issues relating to the issuing of Zohrab J's minute.

(a) The first issue was whether the issuing of the minute demonstrated actual or apparent bias on the part of Zohrab J. In the Courts view, the minute Zohrab J issued simply explains in an objective a way that he was responsible for requesting the summary of facts before the February hearing. Accordingly, there was no actual or apparent bias as there was no nexus or logical connection between Zohrab J issuing his minute and there being a possibility he was biased.

(b) The second issued relates to the minute not being provided to both parties. In the Court's view this was clearly a procedural error and while this reflected poorly on Court administration, it occurred because of a genuine mistake or oversight which does not give rise to an appearance of bias on the part of Zohrab J. The Court also held that there was no actual or apparent bias in this.

Issue 2: Was the application moot and should relief be awarded?

The Court applied the principle confirmed by the Supreme Court in *Unison Networks Ltd v Commerce Commission* CA284/05, 19 December 2006 at [83] that relief in judicial review is discretionary and it is inappropriate for the Court to exercise its discretion to grant relief where it could serve no purpose or have practical effect.

To this end the Court accepted the Attorney-General's submission that the application is moot and there would be no practical effect of granting relief in this case. The charges against Mr Rowell had been transferred to the Wellington District Court and Zohrab J was not going to preside over any further proceedings involving Mr Rowell. There was accordingly no need for Zohrab J to recuse himself and even if he did, it would have no effect.

Court of Appeal confirms a lease surrender payment is a revenue receipt in the hands of the landlord

Case	*Easy Park Limited v Commissioner of Inland Revenue* [2018] NZCA 296
Decision date	7 August 2018
Act(s)	Income Tax Act 2007 s CB 1
Keywords	Capital revenue distinction, lease surrender payment, taxable income

Summary

In the High Court, Ellis J concluded that the lease surrender payment received by Easy Park Limited ("Easy Park") was revenue and not a capital receipt in Easy Park's hands upholding the Commissioner of Inland Revenue's ("the Commissioner") classification of the lease surrender payment as taxable income. Easy Park appealed to the Court of Appeal.

The Court of Appeal agreed with the Commissioner and Ellis J in holding that the lease surrender payment in the hands of Easy Park was revenue and therefore taxable income. The appeal was dismissed.

Impact

This decision confirms that a lease surrender payment received by a landlord that is in the business of leasing commercial properties is considered revenue and not capital meaning it is taxable income in the hands of the landlord.

Facts

Easy Park was a company that was formed for the sole purpose of undertaking commercial rental property investments.

In 2003 Easy Park acquired two commercial buildings in Wellington one of which was a four-storey building situated in 312 Lambton Quay ("the Whitcoulls Building").

Easy Park purchased the Whitcoulls Building subject to a lease to Whitcoulls Group Limited ("WGL"). The lease was for a term of 12 years and three months commencing on 1 June 2003.

On 17 February 2011 WGL was placed into voluntary administration. The administrators of WGL sold its business and assets to Whitcoulls 2011 Ltd ("W2011"). W2011 took occupation of the Whitcoulls Building without an assignment of the lease to WGL.

In June 2011 W2011 publicly announced that it would be vacating the Whitcoulls Building.

In August 2011 WGL assigned its lease to W2011 with effect from 21 June 2011. At that stage there was three years and three months remaining on the lease.

In November 2011 Easy Park and W2011 entered into negotiations for early termination of the lease. Easy Park and W2011 agreed to an amount of $1.1 million to be paid by W2011 for early surrender ("the lease surrender payment").

On 7 February 2012 Easy Park and W2011 entered into a deed of surrender of lease providing for a surrender date of 30 June 2012.

In its income tax return for the year ended 31 March 2012, Easy Park treated the receipt of the lease surrender payment as a non-taxable capital amount.

The Commissioner disagreed and assessed the surrender payment as being business income subject to income tax of $308,000. The Commissioner also imposed a shortfall penalty of 10%.

Ellis J upheld the Commissioner's classification of the lease surrender payment as taxable income but quashed the imposition of a shortfall penalty finding that the tax position taken by Easy Park was not unacceptable.

Easy Park appealed.

Decision

Appellant's argument that the lease was part of the capital asset

The Court rejected the appellant's argument that the lease to WGL was part of the capital asset acquired by Easy Park when it purchased the freehold in the Whitcoulls Building.

The Court agreed that Easy Park purchased the freehold in the Whitcoulls building under its sale and purchase agreement and that this was clearly a capital asset.

The Court did not accept that the lease to the Whitcoulls Building can be "tacked on" to the capital asset by virtue of the lease being in place when the property was purchased.

Easy Park did not acquire a leasehold interest in land. Easy Park acquired a freehold estate that was subject to a lease that belonged to WGL and later W2011.

Characterisation of lease surrender payment as revenue

The Court agreed with Ellis J and the Commissioner that the lease surrender payment was revenue and subsequently taxable income.

The Court proceeded on the basis of the principle outlined by Richardson J in *AA Finance Ltd v Commissioner of Inland Revenue* (1994) 16 NZTC 11,383 (CA) at 11,391, that the nature of a receipt for income tax purposes depends on what the amount received was calculated to effect from a practical business point of view.

The Court held that Easy Park's sole business was in leasing commercial properties. It generated income in the form of rent for those properties. That rent is indisputably income. The lease surrender payment essentially had the same character as the payment of rents that Easy Park generated as income when leasing those commercial properties. It was a lump sum made on account of the rent forgone by the landlord meaning from a practical business point of view, the lease surrender payment was income.

The Court recognised that early surrender payment may have been determined by reference to rent lost, it was necessarily received as revenue. The authorities are clear that character of a receipt is not to be determined by the measure or method used to quantify the payment.

The Court accepted the termination of the lease and associated receipt, although unwelcome, constituted part of the ordinary business activities of Easy Park as a commercial lessor. The Court agreed with Ellis J that the lease surrender was simply an ordinary if unwanted incident of Easy Park's core and only business of commercial leasing.

The Court rejected the appellant's alternative arguments

The Court rejected the appellants submissions based on *Regent Oil Co Ltd v Strick (Inspector of Taxes)* [1966] AC 295 (HL), *Commissioner of Inland Revenue v McKenzies (NZ) Ltd* [1988] 2 NZLR 736 (CA), and *Commissioner of Inland Revenue v Wattie* [1999] 1 NZLR 529 (PC), distinguishing those cases from this case primarily on the basis that Easy Park was a commercial lessor. The lease surrender payment received by Easy Park was in course of its ordinary business operations and the lease was held on revenue account.

The Court rejected the appellant's argument that the financial impact of the termination affected the structure and core of Easy Park's business. It was noted that:

(a) In March 2011 the Wellington City Council gave Easy Park notice that the Whitcoulls Building was earthquake prone and required strengthening by 29 March 2015.

(b) Easy Park surrendered their lease with Lifestyle Gym before commencing strengthening work.

(c) While it was sensible for Easy Park to do it this way in order to secure a new tenant, however it did not follow that the lease surrender was the cause of the cost of the earthquake strengthening work.

(d) Apart from having to pay insurance on the building (which was previously borne by WGL and then W2011) Easy Park's business continued after the earthquake work as before.

High Court confirms amounts dealt with on property consultant's behalf attributable as income

Case	*Krasniqi v Commissioner of Inland Revenue* [2018] NZHC 2075
Decision date	14 August 2018
Act(s)	Tax Administration Act 1994 ss 89A, 138G; Income Tax Act 2007 ss BD 3, CA 1, (CB 6, CB 7)
Keywords	Issue exclusion, onus and standard of proof, allocation of income, income under ordinary concepts

Summary

Ethnik Krasniqi ("Mr Krasniqi") had not filed any returns for the 2005 to 2011 income years. The Commissioner of Inland Revenue ("the Commissioner") conducted an investigation which revealed Mr Krasniqi had undertaken consultancy work in New Zealand during this period. Substantial payments had been made from entities which Mr Krasniqi had worked for to his family members and third parties in Australia, where Mr Krasniqi's family was based. Mr Krasniqi also had access to an eftpos card connected to one of these entities and he used that card to cover personal expenses. The investigation also revealed Mr Krasniqi was the primary beneficiary of a family trust. The Commissioner issued default assessments in respect of payments she considered had been received by Mr Krasniqi or paid or dealt with on Mr Krasniqi's behalf or in his interest. The Taxation Review Authority ("TRA") upheld the majority of the Commissioner's assessments. Mr Krasniqi appealed the High Court and the Commissioner cross-appealed. The matter was heard before Wylie J in the High Court. His Honour dismissed both Mr Krasniqi's appeal and the Commissioner's crossappeal.

Impact

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

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

Note should be taken of the Judge's expressed view that costs should lie where they fall as a result of the Commissioner being unsuccessful in her cross-appeal. In considering whether to cross-appeal in future cases, the possibility of not being awarded costs should be taken into account.

Facts

Mr Krasniqi is a New Zealand citizen and tax resident, who was involved in property trading and land development as a consultant during the disputed period (being the 2005-2011 income years). He primarily provided his consultancy services in connection with the business dealings of his father and two childhood friends "Mr Brown" and "Mr Smith" ("associates"). The Commissioner assessed deposits and expenditure of trusts and other entities of his associates as income to Mr Krasniqi because she considered he received them in exchange for consultancy services provided. Other deposits from unknown sources into Mr Krasniqi's personal bank account and the bank account of a related trust "the Krasniqi Discretionary Trust" have also been assessed as income to Mr Krasniqi.

The Commissioner was largely successful in the Taxation Review Authority ("TRA"), but certain isolated amounts which had either been paid by Mr Brown to an outfit in Thailand or which had not originated from entities controlled by his associates had been found not assessable as income to Mr Krasniqi under ordinary concepts.

Mr Krasniqi appealed to the High Court in respect of certain (but not all) of the payments which had been found attributable as income to him and the Commissioner cross-appealed in respect of all of the amounts which the TRA found not assessable.

Decision

Section 138G(2) Application

The High Court confirmed the TRA's decision not to allow new issues, which had not been included in the Mr Krasniqi's Statement of Position ("SOP"), to be raised.

Wylie J noted that the Commissioner had provided substantial information to Mr Krasniqi and his solicitor throughout the disputes process and had reasonably informed Mr Krasniqi of certain documents in the Commissioner's position which it was expected that Mr Krasniqi could source for himself. Mr Krasniqi had been given lists of documentary evidence held by the Commissioner, but had not requested copies of those and had not taken up the opportunity to attend a facilitated conference when offered to him, instead sending his legal advisor. Mr Krasniqi himself had not been forthcoming in providing documents despite promises being made to this effect.

In the circumstances, Mr Krasniqi's argument that it was not until after discovery had been provided that he had been able to understand the basis for the Commissioner's assessments was not accepted.

Mr Krasniqi's Appeal

Wylie J dismissed Mr Krasniqi's appeal on all points, noting that Mr Krasniqi had failed to discharge the onus of proof and had not provided any corroborating documentation or witness statements to support his various explanations.

With respect to the $1,309,185.04 worth of deposits into the Krasniqi Discretionary Trust, his Honour found that the TRA had correctly found the amount assessable to Mr Krasniqi on the basis of the evidence that he was the primary beneficiary of the trust and had some (albeit limited) authority with respect to the trust's bank account. The Court further noted that there was a correlation between the use of Mr Krasniqi's personal account and the use of the trust account with eftpos transactions on the same dates and places and transfers between the accounts.

With respect to the $105,000 payment by Mr Brown's entity to an outfit called "Roverland", Wylie J noted that there were several avenues open to Mr Krasniqi for corroborating his blanket denial that this vehicle was not purchased for his personal use. For example, he could have called Mr Brown or other business associates or personal friends to give evidence about his usual mode of transport while in New Zealand. Accordingly, Mr Krasniqi had failed to discharge the onus on this issue also.

More finely balanced was the $100,025 international payment from Mr Brown's entity which contained a reference to Mr Krasniqi's brother, Flamur Kransiqi. The Court noted that while there was a reference to Flamur Krasniqi on the payment reference, the payment was not itemised in Flamur Krasniqi's Australian bank statements in the same way as other payments from Mr Brown's entities had been. Again, the onus being on Mr Krasniqi, who had not called any witnesses or produced any documents to show this payment was not his, the High Court found that the TRA had correctly found the amount assessable as his income.

Finally the Court also dismissed Mr Krasniqi's appeal in respect of certain payments which Mr Krasniqi argued were related to the acquisition and subsequent sale of a residential property in Remuera which he claimed he had used as his private home. Mr Krasniqi had originally put forward both in his Notice of Proposed Adjustment and his SOP that he did not have a permanent place of abode available to him and thus was not a tax resident (an argument abandoned early in the proceeding as Mr Krasniqi was clearly caught by the day count test). Wylie J noted that Mr Krasniqi's recent claim that the amounts related to the acquisition and sale of his private home was not only uncorroborated, but "conflicting, unconvincing and totally self-serving".

The Commissioner's Cross Appeal

The High Court agreed with the TRA's finding that one deposit for AUD $519,351.45 from Sun Marine Services into Mr Krasniqi's Australian bank account was not assessable as income to Mr Krasniqi because it was not a payment from any of Mr Krasniqi's associates, but from an unrelated third-party entity and was likely the sale of a boat which would not ordinarily be taxable and thus not income under ordinary concepts. On the same basis, two deposits totalling $66,300 from the same entity into the Krasniqi Discretionary Trust were also found not assessable.

Two further transactions of $10,020 and $12,020 from Mr Brown's entities to an entity in Phuket were also found not to be income attributable to Mr Krasniqi because Mr Krasniqi could not be connected to the payments in Thailand.

Forgiveness of debt held to be a "monetary" gift

Case	*Nancy Lois Roberts v Commissioner of Inland Revenue* [2018] NZHC 2153
Decision date	21 August 2018
Act(s)	Income Tax Act 2007 ss LD 1 and LD 3
Keywords	Charitable trust, forgiveness of debt, tax credits, charitable or public benefit gift, monetary gift

Summary

Nancy Lois Roberts ("Mrs Roberts") challenged a decision of the Commissioner of Inland Revenue ("the Commissioner") disallowing charitable tax credits for gifts she made to the Oasis Charitable Trust ("the Trust"). At issue was the meaning of "a monetary gift of $5 or more that is paid…" under s LD 3(1)(a) of the Income Tax Act 2007 ("the Act") and whether Mrs Roberts' forgiveness of debt of the Trust constituted "a monetary gift". The Commissioner argued that forgiveness of a debt is not a charitable gift within the meaning of ss LD 1 and LD 3 of the Act, because "monetary" means the payment must be made in cash form only.

The Court found in favour of Mrs Roberts.

Impact

The judgment clarifies that forgiveness of a debt owed by a qualifying entity can constitute a "monetary gift … paid" to such a trust.

The judgment further determines that in appropriate circumstances, taxpayers forgiving debt owed to them by charitable trusts can claim tax credits for such forgiveness.

Facts

Mrs Roberts and her husband jointly established the Trust on 14 October 2007 and registered it with the Charities Commission in November 2007. The Trust's charitable objects were to facilitate the growth of Christian faith within New Zealand by helping local churches, providing assistance to people in need of shelter, clothing and education, and by raising money for the benefit of the community.

On 16 October 2008, Mr and Mrs Roberts loaned $1,708,080.90 to the Trust in the form of a bank term deposit, with $500,000 to be invested in Telecom bonds and the remainder on a term deposit with interest to be reinvested in the name of the Trust.

In each income year ending 2011 to 2015, Mr and Mrs Roberts executed Deeds of Gift which released the Trust from liability to repay specified amounts of the loan. They then claimed a tax credit for each of those five years on the basis that the forgiveness of debt was a charitable gift. Those credits totalled $91,577.24, corresponding to $274,732 of forgiven debt.

The Commissioner wrote to Mrs Roberts on 1 December 2015 initiating a risk review with respect to her claimed tax credits. On 4 May 2016, as a result of the review, the tax credits were reversed and Mrs Roberts was requested to repay them.

Decision

Interpreting the meaning of "monetary", the Court first looked at the legislative history of ss LD 1 and LD 3. The predecessor of these sections in the Income Tax Act 2004 was s KC 5 which allowed rebates for gifts of "money of $5 or more…" The Court found that Parliament intentionally removed the word "money" when enacting ss LD 1 and LD 3 of the (2007) Act. The Court saw significance in the fact that Parliament later redressed questions raised about this removal by qualifying the gift with the phrase "monetary" on 27 February 2014 (Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Act 2014, ss 2 and 103), rather than restoring the previous wording of "money". The Court said because Parliament chose to sue a broader phrase,, this suggested a broader scope to the provision. If Parliament sought to restrict tax credits to cases of cash donations only, it could have clearly amended the section to reflect that.

The Commissioner argued that potential mischief may arise from a finding that forgiveness of a debt can be charitable gift, including the fact that it could be difficult to verify the details of loans made many years prior, it would provide the opportunity for taxpayers to manipulate books of account to reflect loans that have in substance not been made, and valuation issues could arise in cases where a charitable trust becomes insolvent and the loan has been reduced to a lower sum than its face value.

The Court found that forgiveness of debt does not raise the same issues of valuation that arise for donations of chattels or property, which are outside the scope of s LD 3 (*Roberts v Commissioner of Inland Revenue* [2018] NZHC 2153). It held that forgiving a debt places a charity in a better position than before, as well as in the same position as if a taxpayer had made a cash donation. Finally, the Court found that the administrative costs incurred by the Commissioner would be the same whether the donation was made in cash or in the form of forgiveness of debt, making the prospect of mischief minimal.

The Court held that "monetary" is a broader concept than "money" in the form of cash and did not accept that "monetary gifts" must be cash only. The value of the gift is the monetary figure that is credited to the recipient.

The Court found that Mrs Robert's gifting programme, by which, each year the Trust's debt was forgiven in portion, by Deeds of Gift, resulted in the Trust's liability being reduced each year. The Trust was the recipient of a gift in the express amount of the relevant Deed of Gift, and such sums qualify as gifts.

The Court held that to require monetary gifts to be made in cash only, as the Commissioner submitted, artificially restricts the legislative language of the Act (at [57]).

Regarding the meaning of "paid" in s LD 3 of the Act, the Court noted case law authorities consistently recognise that payment can be effected by the reduction of a debt (see *Databank Systems Ltd v Commissioner of Inland Revenue* [1990] 3 NZLR 385 (PC); *In re Harmony and Montague Tin and Copper Mining Co (Spargo's Case)* (1873) LR 8 Ch App 407 (EWCA); *North Sydney Investment and Tramway Co Ltd v Higgins* [1899] AC 263 (PC); and *Healing Industries Ltd v Commissioner of Inland Revenue* (1988) 10 NZTC 5,115 (HC)), thus Mrs Roberts' monetary gifts were "paid" to the Trust within the meaning of the Act.

The Court found that Mrs Roberts' forgiveness of the Trust's debts were monetary gifts of $5 or more paid to a charitable trust within the scope of s LD 3 of the Act, and therefore Mrs Roberts was entitled to claim tax credits for the years ending 2011 to 2015.

Application for leave to appeal to the Supreme Court

Case	*Garry Albert Muir v Commissioner of Inland Revenue* [2018] NZSC 81
Decision date	29 August 2018
Act(s)	Tax Administration Act 1994 ss 3, 142F and Part 8A
Keywords	finally determined, leave to appeal, summary judgment, deferral of liability

Summary

Garry Albert Muir sought leave from the Supreme Court to appeal a decision a decision of Associate Judge Bell in which he entered summary judgment in favour of the Commissioner of Inland Revenue ("the Commissioner") against Dr Muir for unpaid taxes, interest and penalties for the 1997–2010 tax years. At issue was whether previous leave and revocation decisions of the Court determined the challenges that were then before the Court.

The Court found in favour of the Commissioner and did not grant leave.

Impact

When a proceeding is struck out, the proceeding (not just the pleadings) are struck out.

Where a Court enters summary judgment, it creates a res judicata (even if susceptible to appeal) that the tax debt is owing.

Facts

The Commissioner made assessments against Dr Muir for unpaid taxes, interest and penalties for the 1997–2010 tax years. He challenged all of these assessments under the Tax Administration Act 1994 ("the TAA").

Mr Muir filed the challenges for the 1998–2006 assessments with the Taxation Review Authority ("the Authority"). The other assessments were challenged in the High Court.

The Authority struck out the challenges against the 1998–2006 assessments on 1 February 2011.

Faire J in the High Court struck out the challenges to the 1997 and 2007–2010 assessments and dismissed Mr Muir's appeal from the Authority's 2011 decision.

The Court of Appeal dismissed an appeal against Faire J's judgment on 8 December 2015 ("the 8 December 2015 decision").

Mr Muir applied for leave to appeal to the Supreme Court. This was dismissed in relation the 1997 and 1998 tax years but leave was granted in relation to the 1999 – 2010 tax years on 20 July 2016 ("July 2016 decision").

This grant of leave was revoked on 26 August 2016 ("August 2016 decision") meaning, as the Court noted in the August 2016 decision,"[t]he consequence is that the decision of the Court of Appeal will stand, and the appellant's proceedings will remain struck out in their entirety".

The Commissioner subsequently obtained summary judgment against Dr Muir and, having unsuccessfully appealed to the Court of Appeal, Dr Muir sought leave to appeal to the Supreme Court.

Decision

Dr Muir argued that as he had extant appeals in the Court of Appeal (against decisions to not accept amended statements of claim for filing):

Associate Judge Bell entering summary judgment, in substance, determined the challenge proceedings and such a collateral determination is inconsistent with Part 8A of the TAA;

the Court of Appeal's recognition that the extant appeals might be resolve in favour of Dr Muir (and thus he would have tax challenges before the hearing authority) is inconsistent with upholding the summary judgment.

The Court requested further submissions on two matters:

Whether challenge proceedings remained on foot after the July 2016 and August 2016 decisions; and

the possible application on res judicata to the extant appeals (i.e. did Associate Judge Bell's entry of summary judgment preclude the extant appeals being determined in favour of Dr Muir).

Dr Muir filed further submissions claiming that the first matter involved "relevant contested facts" in respect of an issue still sub judice and likely to come before this Court and that *Ben Nevis* did not give rise to an estoppel or res judicata preventing Dr Muir from advancing amended statements of claim. On the second matter, Dr Muir asserted that a judgment susceptible to appeal (as Associate Judge Bell's summary judgment was) does not give rise to a res judicata.

The Court found that Associate Judge Bell was entitled to determine the question whether the challenge proceedings had been finally determined. His judgment (unless successfully challenged) created a res judicata and controls the results in the other litigation stream.

Although it is possible to find authority that a judgment susceptible to appeal does not create a res judicata, there is substantial authority that a judgment is relevantly final for the purposes of res judicata even if susceptible to appeal. In this case though, Dr Muir's argument that Associate Bell's judgment does not create a res judicata completely fails if this current application for leave is dismissed at it is no longer susceptible to appeal.

The grant of the summary judgment turns on the conclusion that the challenge proceedings have been finally determined, which in turn is premised on the July 2016 and August 2016 decisions resulting in the challenge proceedings, not just the pleadings, being struck out. This does not rest on res judicata but on the simple proposition that striking out a proceeding means the proceeding has been determined and cannot be revived by filing a further statement of claim.

Given the way that the judgments, particularly the Court's revocation judgment were expressed "the conclusion that the proceedings were at an end might thought to be reasonably clear". In any event, the appeal does not give rise to a question of public or general importance, nor does the Court see any appearance of a miscarriage of justice.

The application for leave to appeal was dismissed.

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