

TAX INFORMATION

Bulletin

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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

Product rulings

BR Prd 18/06: Industrial and Commercial Bank of China (New Zealand) Limited

This product ruling concerns a mortgage offset banking product that the Bank offers to those customers who take out a home loan.

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BR Prd 18/07: Millwood Forest LP and others

This product ruling concerns the formation of an unincorporated joint venture by six limited partnerships who each own a forest in the Emerald Hills Forest Estate to facilitate the efficient and effective harvest of their timber.

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Interpretation statements

IS 18/07: Goods and services tax - zero-rating of services related to land

This Interpretation Statement concerns an amendment to the Goods and Services Tax Act 1985 on the circumstances in which services related to land can be zero-rated under s 11A(1)(e) and (k). Broadly, s 11A(1)(k) provides that services supplied to non-residents who are outside New Zealand at the time the services are performed are eligible for zero-rating if they are not either directly in connection with land in New Zealand, or in connection with land in New Zealand and intended to enable or assist a change in the physical condition, ownership or other legal status of that land. There is a corresponding rule in s 11A(1)(e) for services supplied in relation to land outside New Zealand. This item sets out the Commissioner's views on the "directly in connection with" test and the new test.

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Questions we've been asked

QB 18/15: GST – When will goods and services supplied in connection with the repatriation of human remains from New Zealand be zero-rated?

This item considers the GST treatment of goods and services supplied in relation to the repatriation of human remains from New Zealand overseas. In particular, it considers when the goods and services can be zero-rated. It updates and replaces PIB 168 "GST on Human Remains for Repatriation" (January 1988: 5).

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QB 18/16: Income tax - bright-line test - main home exclusion - sale of subdivided section

The bright-line test for residential land taxes residential land sold within the bright-line period. This item explains that a subdivided section sold within the bright-line period will be excluded from the bright-line test for residential land when more than 50% of the area of the land in the subdivided section has been used for a dwelling that was the seller's main home; and the seller has used the land in the subdivided section in that manner for more than 50% of the time since the seller acquired the undivided land.

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QB 18/17: Income tax - bright-line test - farmland and main home exclusions - sale of lifestyle blocks

The bright-line test for residential land taxes residential land sold within the bright-line period. This item explains that lifestyle blocks sold within the bright-line period will be excluded from the bright-line test when the lifestyle block is farmland; or the lifestyle block is residential land and is the seller's main home, and more than 50% of the area of the lifestyle block has been used for the seller's home, curtilage and residential purposes, and the lifestyle block has been used in that manner for more than 50% of the time the seller has owned it.

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Legislation and determinations

Determination DET 18-02: Amount of honoraria paid to Royal New Zealand Plunket Trust volunteers that shall be regarded as expenditure incurred in production of that payment

This determination is made under section RD 8(3) and shall apply to honoraria paid to the Royal New Zealand Plunket Trust ("Plunket") volunteers who undertake voluntary activities for Plunket.

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IN SUMMARY (continued)

Legal decisions - case notes

Court of Appeal holds that expenditure incurred in deriving dividends is deductible pursuant to s DB 55 of the Income Tax Act 2007

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In its tax returns for the 2011 and 2012 income years, NRS Media Holdings Ltd (“NRS”) claimed deductions for expenditure incurred in deriving exempt foreign dividends. The Commissioner of Inland Revenue (“the Commissioner”) disallowed those deductions on the basis that the expenditure did not have the necessary nexus with the dividends.

NRS commenced challenge proceedings in the High Court; Clark J upholding the Commissioner’s determination (NRS Media Holdings Ltd v Commissioner of Inland Revenue [2017] NZHC 2978, (2017) 28 NZTC 23-048). NRS appealed and the Court of Appeal held that the expenses for which NRS claimed deductions represent recurrent and regular business expenses, which are all manifestly revenue expenses. The Court of Appeal accordingly held that NRS ought to be entitled to a deduction for these expenses

Application to appeal decisions relating to proceedings that have been struck out

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The appellant, Garry Albert Muir (“Dr Muir”) brought separate appeals in relation to two High Court decisions. The first High Court decision (per Toogood J), Muir v Commissioner of Inland Revenue [2017] NZHC 2082, (2017) 28 NZTC 23-029, concerned the Commissioner of Inland Revenue’s (“the Commissioner”) challenge of the High Court registrar’s acceptance of Dr Muir’s amended statement of claim for the 1997 and 2007 to 2010 tax years.

The second decision (per Jagose J), Muir v Taxation Review Authority [2017] NZHC 2932, concerned Dr Muir’s judicial review application of the Taxation Review Authority’s (“TRA”) refusal to accept for filing an amended notice of claim for the 1998 to 2006 tax years. In both cases, the High Court found for the Commissioner.

In this proceeding, before the Court of Appeal, Dr Muir appealed both High Court decisions on the basis that in his view he was entitled to replead his challenge proceedings as they involved facts the courts had not previously considered. Ultimately, the Court of Appeal found for the Commissioner, awarding her costs and dismissed both of Dr Muir’s appeals.

High Court grants third party access to Court file

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Kea Investments Ltd (“Kea”), a successful party in a recent decision of the High Court of England and Wales (Glenn v Watson [2018] EWHC 2016 (Ch)), is considering options for enforcement against Cullen Group Ltd (“CGL”). This decision relates to Kea’s application to access court documents, specifically the formal court record of judgments, orders and minutes of the court, pursuant to r 8 of the Senior Courts (Access to Court Documents) Rules 2017 (“the Rules”).

Kea also requested access to the pleadings, submissions and index to the agreed bundle of documents pursuant to r 11 of the Rules. The Commissioner of Inland Revenue (“the Commissioner”) and CGL agreed to abide the Court’s decision with respect to r 8 however, counsel for CGL opposed access to the information requested under r 11. The Court, in noting the public interest element in favour of disclosure, granted Kea’s request under both rules.

BINDING RULINGS

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

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

PRODUCT RULING — BR PRD 18/06

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of the person who applied for the Ruling

This ruling has been applied for by the Industrial and Commercial Bank of China (New Zealand) Limited (the Bank).

Taxation Laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated. This Ruling applies in respect of:

- ss BG 1, CC 7, EW 15, EW 31, GA 1, RE 1–6, RE 10, RF 1–4; and
- ss 86F and 86I of the Stamp and Cheque Duties Act 1971 (SCDA).

The Arrangement to which this Ruling applies

The Arrangement is a mortgage offset banking product (the Product) that the Bank offers to those customers (individuals) who take out a home loan.

For the purposes of this product ruling, the term “Specified Account” as defined in the Home Loan and Personal Loan General Terms and Conditions documentation means “Specified Deposit Account”.

The Product involves “offsetting” (for interest calculation purposes) a home loan account balance (the “offset portion”) against a credit balance in a Specified Deposit Account. This reduces the interest payable by a customer on their home loan balance.

The Arrangement is set out in the documents listed below, copies of which were received by the Taxpayer Rulings Unit, Inland Revenue, on 20 August 2018:

- General Terms and Conditions;
- Home Loan Application Form;
- Home Loan and Personal Loan Letter of Offer;
- Home Loan and Personal Loan General Terms and Conditions;
- Home Loan and Personal Loan Agreement;
- Home Loan and Personal Loan Component Tables; and
- Retail Banking Fees and Charges Brochure.

Further details of the Arrangement are set out in paragraphs 1 to 17 below.

1. Customers may have a range of accounts with the Bank, including transaction accounts, savings accounts, and loan accounts. Loan accounts may be table only, reducing, principal and interest, interest only, fixed or variable home loan accounts.

Primary feature of the Product

2. The primary feature of the Product is the offsetting feature.
3. To participate in the Product, a customer must have a home loan with an offset portion. Customers may convert an existing non-offset home loan to an offset home loan account.
4. Where a customer has a loan account with an offset portion, the customer must also have a Specified Deposit Account so interest can be calculated on the offset portion of a customer’s loan.

5. The Product applies an “offset” to an offset portion of a home loan against a Specified Deposit Account, with “offset” being one category of loan applicable to home loans.

How the offsetting works

6. The “offsetting” is only to calculate the interest payable on the offset portion of the home loan.
7. Interest on the offset portion of the home loan is calculated, and paid by the customer, on the difference between the offset portion of the home loan balance and the credit balance of the customer’s Specified Deposit Account. Under the terms and conditions agreed between the Bank and its customers for the Product, the Bank pays no interest on the credit balance that is “offset” against the offset portion of the home loan.
8. Where the credit balance of the customer’s Specified Deposit Account exceeds the balance of the offset portion of the home loan it is “offset” against, the balance of the excess credit balance on which interest is receivable will be subject to the RWT rules, NRWT rules or the AIL rules.
9. The interest payable on the home loan account is calculated by reference to the balance of the offset portion of the home loan less the credit balance of the Specified Deposit Account. This will be the case as a matter of law (in terms of the Product’s documentation) and as a matter of practice (in terms of the Bank’s computer system). There is no actual set-off, netting, or transfer of funds, or transfer of any interest in or entitlement to funds. “Offsetting” occurs before debit or credit interest is calculated.
10. There is no provision for any interest saved under “offsetting” to reduce the “minimum payment”. The effect of “offsetting” is the same as a decrease in the floating interest rate and a decision not to reduce the amount of the “minimum payment”. The term of the loan is reduced because the principal portion of the payment is effectively increased.
11. If the credit balance of the Specified Deposit Account is greater than the debit balance of the offset portion of the home loan, credit interest will be applied to the difference and paid to the credit balance account.
12. Interest is calculated by the Bank on a daily basis. If, during a month, the Bank is both entitled to receive interest (that is, the balance of the offset portion of the home loan exceeds the balance of the Specified Deposit Account) and, at another point in the month, is obliged to pay interest (that is, the balance of the Specified Deposit Account exceeds the balance of the offset portion of the home loan), then the two interest payments are made and are not set-off.
13. The “offsetting” feature of the Product essentially offers the same benefits to customers as a revolving credit loan in terms of lower interest costs and a shorter time to repay the loan. However, this feature overcomes a perceived disadvantage of a revolving credit loan because it allows customers to retain separate account balances (which customers may prefer when managing their finances).

Terms and conditions for the Bank’s home loan products

14. Each of the Bank’s home loans is explained in a collection of documents. These include:
 - a) a Home Loan and Personal Loan General Terms and Conditions (a standard form “master” document, which contains primarily generic provisions that apply to all of the Bank’s personal and home loan facilities);
 - b) a Letter of Offer, which conditionally approves the Bank’s lending arrangements outlining the type of loan and loan amount, as well as any loan-to-value ratio applicable to the loan; and
 - c) a Loan Agreement, which contains details of the parties to the loan, the amounts borrowed and terms and conditions applicable to the loan drawn down by the customer.
15. Table loans provide for regular payments and a set date when they will be paid off. Most payments early in the loan term comprise interest, while most of the later payments comprise principal repayments. Reducing loans have two separate repayments, one of interest and one of principal. Customers repay the same amount of principal each time and interest is charged separately. The Product can be used for both table and reducing home loans, to the extent the loan is subject to a variable offset interest rate.
16. Where an amount of a home loan is subject to offsetting, there are two separate repayments: one of interest and one of principal. Customers repay an amount of principal each time and interest is charged separately. If there is an increase in the variable offset interest rate during the term of the loan, the payment amounts increase so the loan is paid off over the same term as originally agreed between the Bank and the customer. If there is a decrease in the variable offset interest rate during the term of the loan, the payment amounts remain the same and the term of the offset portion of the home loan is reduced (however, a customer has the option to reduce the payment amounts instead if the variable offset interest rates reduce over the term of the loan).

The Bank's objectives

17. The Bank's objectives in providing the Product are to:
- a) increase its market share, particularly for home loans and transaction-type accounts;
 - b) increase customer satisfaction and customer retention; and
 - c) improve its brand awareness and be seen as a market leader.

Condition[s] stipulated by the Commissioner

This Ruling is made subject to the following condition:

- a) All interest rates related to the Product are arm's length market interest rates.

How the Taxation Laws apply to the Arrangement

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

Financial arrangements rules

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

Resident withholding tax (RWT), non-resident withholding tax (NRWT) and approved issuer levy (AIL)

Under the "offsetting" feature of the Product, the following apply:

- a) There is no payment of or entitlement to "interest" (as defined in s YA 1) for the credit balance of a Specified Deposit Account, and no obligation to deduct RWT or NRWT or pay AIL, except to the extent that the credit balance exceeds the debit balance of the offset portion of the home loan.
- b) To the extent that interest is credited to a Specified Deposit Account:
 - i) RWT and NRWT (as defined in s YA 1) must be deducted by the Bank from the interest credited to the Specified Deposit Account in accordance with the RWT rules (as defined in ss RE 1(1) and YA 1) and the NRWT rules (as defined in ss RF 1(1) and YA 1); and
 - ii) for an account that is a "registered security" (as defined in s 86F of the SCDA), "approved issuer levy" (as defined in s 86F of the SCDA) may be paid by an "approved issuer" (as defined in s 86F of the SCDA) for the interest credited to that account pursuant to ss 86F and 86I of the SCDA.

Section CC 7

No income arises under s CC 7 for the Bank or its customers in relation to the Arrangement.

Section BG 1

Section BG 1 does not apply to the Arrangement.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 October 2018 and ending on 30 September 2022.

This Ruling is signed by me on the 15 November 2018.

Vasu Naidu

Group Lead, Customer Compliance - Significant Enterprises

PRODUCT RULING – BR Prd 18/07

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of the Persons who applied for the Ruling

This Ruling has been applied for by:

- Millwood Forest LP
- Glenwood Forest LP
- Goodwood Forest LP
- Homewood Forest LP
- Longwood Forest LP
- Majestic Pine Forest LP

Taxation Laws

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

This Ruling applies in respect of ss BD 3(2), BG 1, CB 24, CB 25 and GC 2.

For the avoidance of doubt this Ruling does not consider or rule on the application of ss DP 11 or EI 1 to the Arrangement.

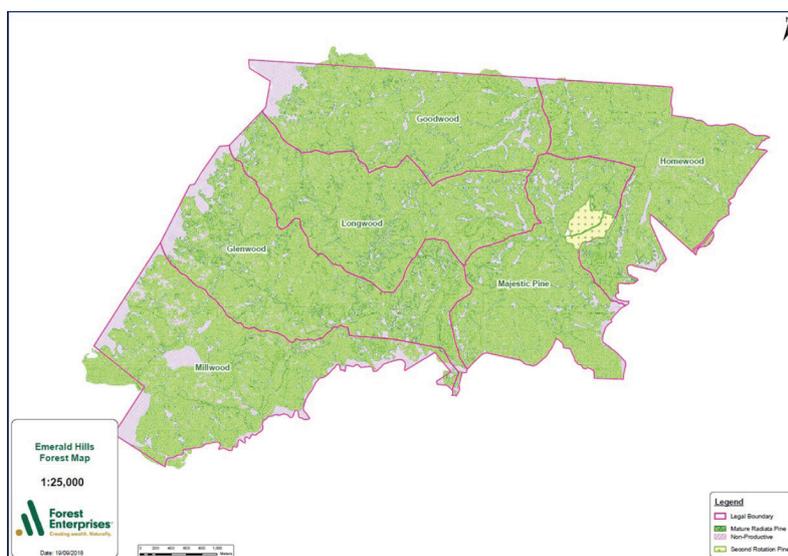
The Arrangement to which this Ruling applies

The Arrangement is the formation of an unincorporated joint venture by six limited partnerships (Millwood Forest LP, Glenwood Forest LP, Goodwood Forest LP, Homewood Forest LP, Longwood Forest LP and Majestic Pine Forest LP) (Forestry Partnerships) who each own a forest in the Emerald Hills Forest Estate in order to facilitate the efficient and effective harvest of their timber. Prior to the commencement of the harvest the land owned by each of the Forestry Partnerships will be transferred to a new limited partnership to allow the planting of the second rotation of trees on that land.

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

Introduction

1. The Forestry Partnerships each own an adjoining parcel of land in the Emerald Hills Forest Estate (Emerald Hills Forest) situated southwest of Gisborne, which was planted with Radiata pine in the early 1990s. These parcels combine to make a total forestry block of approximately 2,379 net stocked hectares.
2. The following map shows the total forestry block and the boundaries between the land parcels owned by the individual limited partnerships.



3. Each of the Forestry Partnerships is a separate managed investment scheme (MIS) registered under the Financial Markets Conduct Act 2013 and regulated by the Financial Markets Authority. Forest Enterprises Limited (FEL) is the manager of the six forestry blocks as well as being the licensed manager (under the Financial Markets Conduct Act 2013) of each MIS.
4. FEL has commenced, or is ready to commence, harvesting the six forests owned by the Forestry Partnerships. It is anticipated that the harvest will extend over a period of nine to ten years.
5. For reasons detailed below (see paras 18 to 20), the Forestry Partnerships and FEL consider that it is almost impossible (both practically and commercially) to harvest the six forests individually. For that reason FEL is proposing the collective harvest of all six forests (Collective Harvest). Practically this means disregarding the boundaries between the six component forestry blocks and undertaking the harvest as a single commercial venture.
6. Any collective arrangement entered into to achieve the harvest must respect each Forestry Partnership's discrete stand-alone status as a MIS and also respect the investment objectives set out in the original Prospectuses. Undertaking the Collective Harvest by way of a joint venture will maintain the standalone status of each MIS. Therefore, it is proposed that the Collective Harvest will be undertaken as an unincorporated joint venture (UJV) governed by a joint venture agreement (JVA).
7. The UJV will preserve the following fundamental characteristics of the Forestry Partnerships' investment:
 - A single rotation investment with harvest occurring at the end of the investment period;
 - A boutique investment primarily for personal investors, family trusts and closely held companies;
 - An investment which provides personal ownership and control by the investors; and
 - An investment which can be visited and enjoyed first hand, rather than being only on paper.
8. To effect the Collective Harvest, each of the Forestry Partnerships will authorise the collective harvest of their mature trees by entering into the UJV by signing the JVA.
9. The Collective Harvest will necessitate each of the Forestry Partnerships to grant themselves a forestry right (Forestry Right), which will separate the ownership of trees from the underlying land on which the trees are planted. Prior to the Collective Harvest the land owned by each of the Forestry Partnerships will be transferred into a new limited partnership.
10. The draft JVA was provided to Inland Revenue on 8 October 2018. The terms and conditions of the final signed version of the JVA will not differ in any material respect from the version provided to Inland Revenue.
11. The parties to the JVA are the Forestry Partnerships and FEL as the manager. The relationship between these entities is that of contracted parties. Under the JVA each Forestry Partnership will continue as an autonomous investment entity but will agree to exchange the revenue arising from the harvest of 100% of the forest on their land for the right to an agreed percentage share of the revenue arising from the Collective Harvest by the joint venture.
12. The JVA sets out the background to the joint venture as follows:

BACKGROUND

- A. Each of the Participants is a limited partnership registered under the Limited Partnerships Act 2008 which owns the land (the "Land") and approximate area of mature radiata pine forest as set out in Schedule 1. These areas of mature radiata pine forest are identified in the forest maps in Schedule 2. The areas of mature radiata pine forest are referred to individually as their "Participant Forest" and collectively as the "Participant Forests".
- B. Each of the Participants is also a managed investment scheme registered under the Financial Markets Conduct Act 2013 with the name and registration number set out in Schedule 1. Forest Enterprises Limited is the licensed manager of each Participant's managed investment scheme.
- C. Each Participant has been authorised (by special resolution passed by the shareholders of its general partner, as set out in Schedule 3 (the "Special Resolutions")) to enter into and perform this joint venture for the benefit of their on-going managed investment scheme.
- D. The Participants now wish to implement the actions authorised by the relevant Special Resolutions by entering into this joint venture for the collective harvest of their Participant Forests by the Manager which will result in each Participant receiving an agreed share of the proceeds from the harvest of the Participant Forests. The Participant Forests are collectively known as the Emerald Hills Group of forests; therefore, the joint venture is named the Emerald Hills Group Harvest Joint Venture (or the "Joint Venture").
- E. The Joint Venture is exclusively for the collective harvest of the Participant Forests and distribution of the proceeds of sale of such collective harvest to the Participants in the agreed shares set out in this Agreement. Therefore, to secure the financial interests of the Participants in the Joint Venture separately from their financial interests in their Land they have agreed to create forestry rights with identical terms and to allow an encumbrance in favour of the other Participants over their forestry right.
- F. The Participants have agreed to cooperate for the benefit of their separate businesses by entering into this Joint Venture the basis and terms of which are set out in this Agreement.

History of Emerald Hills

13. FEL contracted to purchase Emerald Hills Station, a 2,836-hectare property, in 1992. Settlement was in three equal tranches:
 - 17 December 1993: title for the Glenwood and Millwood blocks transferred;
 - 31 March 1994: title for the Longwood, Pinewood (later renamed Majestic Pine) and Goodwood blocks transferred; and
 - 30 June 1994: title for the Homewood block transferred (as well as titles to the residual blocks).
14. Settlement related to the release of the six forestry blocks (which became investments) which were subdivided from the total property. Various houses and related station improvements (woolshed, yards etc) which were not included in the investments were sold off separately by FEL.
15. The Prospectuses for the six investments were registered progressively as follows:

Investment name	Prospectus registration date
Millwood	24 September 1993
Glenwood	15 October 1993
Longwood	3 December 1993
Majestic Pine	25 February 1994
Goodwood	18 March 1994
Homewood	6 May 1994

16. Each of the six investments was fully subscribed for in relatively quick succession, as reflected by the close sequence of prospectus registration dates.
17. The Forestry Partnerships all commenced as partnerships of qualifying companies and subsequently transitioned to limited partnerships (as a result of the enactment of the Taxation (GST and Remedial Matters) Act 2010, which repealed the Loss Attributing Qualifying Company regime).

Background to undertaking the forest harvest

18. In planning for the harvest, FEL has taken account of the significant other areas of 1990's planted forest outside of FEL's management that will also require harvesting. The Forestry Partnerships and FEL consider it is likely that all 1990 forest areas (not just those managed by FEL) are going to be competing for:
 - Harvest infrastructure - including logging, roading and cartage contractors.
 - Access to sensitive roads - some roads are not able to be used in winter or have restricted access in winter.
 - Limited domestic market options in the Gisborne area. There is a mill located outside of Wairoa that requires small volumes of logs, but this mill is better serviced from the harvest of other forests. The large Juken New Zealand mill on the outskirts of the city of Gisborne seldom buys third party logs as they own a substantial forest resource. Consequently, almost all the logs from the Collective Harvest of the Emerald Hills Forest will be exported.
 - Limited port space for the large percentage of logs that must be exported. FEL's harvest program scheduling in the Gisborne region is predicated on the second berth development proposed for the Eastland Port occurring. Following this development, FEL estimates that it will then be able to export a maximum of 750,000 tonnes per annum through the Eastland Port. Based upon the port's expected maximum capacity, the Collective Harvest of the Emerald Hills Forests will take nine to ten years starting when the oldest trees are 24 years old (in 2018) and finishing when the trees will be 34 years old (in 2028).
 - Potentially limited market uptake.
19. FEL is also mindful of the increasing impact of changing legislative requirements including:
 - Resource Management Act 1991—the prospect of harvest quotas per river catchment, and maximum continuous clearfell areas per annum.
 - Health and safety regulation - incentivising more machinery and less labour requiring different relationships with harvest contractors who have more capital invested.

20. FEL also needs to resolve the impact of the following factors that will affect the harvest of the Forestry Partnerships' forests:
- Each Forestry Partnership has a relatively large forest area in just two or three age classes - consequently it is not possible to harvest each age class at the selected optimum age (historically around age 28 years).
 - The Forestry Partnerships' forest areas are contiguous. This arose from the historical consequence of the legislative environment necessitating the subdivision of farms purchased for investments into multiple MIS. However, this gives rise to material boundary issues and it is recognised that the most efficient harvest will be achieved by ignoring these artificial boundaries.
 - Vulnerability to access from one public road. However, by collective harvesting, FEL will have the choice of three major and two minor road connections and therefore the ability to operate via any of these depending upon weather, status of the internal roads and other circumstances.
21. The circumstances described in paras 18 to 20 mean that it is extremely impractical (nearing practically and commercially impossible) to harvest the six forests individually. However, a Collective Harvest will mean that the combined operation will be of sufficient scale to attract the interest of major contractors across the whole gamut of harvesting and log sale service providers. This means that FEL will be able to interact with the service providers in a way that translates into further economies and value to the Forestry Partnerships.
22. This larger scale also enables FEL to attract top forestry professionals to manage the harvest, plus enter into logistics solutions in conjunction with transportation providers and the ports.

FEL's role and responsibilities

23. FEL's obligation in respect of the Forestry Partnerships is to act in accordance with the Financial Markets Conduct Act 2013, the governing documents, and the Statement of Investment Policy and Objectives (SIPO).
24. The investment objective for the Forestry Partnerships is expressed in the SIPO as follows:

Investment Objectives - Primary Assets

The investment focus is on the Primary Assets as they contribute most to the investment return.

Treecrop

Of the two Primary Assets, the Treecrop is projected to contribute the largest portion of the investment return. The return generated from the harvest of the TreeCrop is enhanced by the silviculture operations performed on the trees (pruning and thinning operations), plus the quality of the harvest management.

The investment objectives for the Treecrop are -

1. To maximise the eventual return from the TreeCrops harvest by undertaking industry best practice silviculture operations identified as being able to add value to the Treecrop; and
 2. To maximise the return at harvest by using industry best practice harvest methods identified as being able to add value; and
 3. To contract with quality service providers able to add value to the silviculture and harvest activities; and
 4. To harness the scale and common interests of the investment with those of other investments managed by the Manager to maximise the investment return.
25. FEL has a legal responsibility to act to resolve any known challenges, in addition to its underlying business focus to achieve the best investment outcome for investors. Clause 24.1(h) of the Deed of Scheme Management states that FEL may:
- (h) ... enter into any arrangement to profit sharing union of interest, amalgamation, cooperation, joint venture, reciprocal concessions, licensing, distribution or otherwise with any person which is consistent with the Plan [The Plan means the plan for planting, tending, maintaining, managing, harvesting trees on the land and carrying away any forest produce set out in the Prospectus] and the objects of the Limited Partnership and which will directly or indirectly benefit the Limited Partnership and to take or otherwise acquire or deal in choses in action, choses in possession, shares in securities of any such person and to sell, hold, reissue with or without guarantee or otherwise deal with the same and to grant licences and rights to any property of the Limited Partnership to any such person;

Collective Harvest by Unincorporated Joint Venture

26. Collective harvesting as a UJV means there will be no regard to each Forestry Partnership's forest boundaries. Harvesting will be focused on the most cost-effective harvest of the entire area of joint venture forest, regardless of which of the Forestry Partnerships is the legal owner of the trees.

Details of the Collective Harvest

27. While the typical harvesting age of Radiata pine is 28 years, harvesting of the Emerald Hills Forest will begin early (before the oldest trees are 28 years) and finish late (after the youngest trees are 28 years). All other factors being equal, the quantum of stumpage per hectare will be less but early for the younger trees harvested and more but later for the older trees harvested. The balance between early and late harvest is targeted to achieve an average age of the trees at harvest of the original Prospectus target of around 28 years.
28. Collective Harvest in this manner over nine to ten years creates the environment for each Forestry Partnership to resolve as best possible the known harvesting challenges and achieve the targeted objectives.
29. The objective of the Collective Harvest joint venture is specifically:
- To ensure the forest of each Forestry Partnership is able to be harvested;
 - To maximise the opportunity for a better (more profitable) harvest outcome for each Forestry Partnership;
 - To minimise all risks for each Forestry Partnership, including crop, access to domestic markets and access to port;
 - To aim to achieve an average age at harvest of approximately 28 years (reflecting the original expectation in the relevant Prospectus for each Forestry Partnership).
30. The objective is also to endeavour to meet the investors' expectations around timing of harvest, and therefore the timing of payment of the investment return. To a degree this objective has to be compromised to achieve the other objectives. However, the UJV will finish the Collective Harvest no later than four years after the harvest conclusion expectation set out in the relevant Prospectus. Directly or indirectly, achieving the targeted objectives should translate into increased return or less risk of reduced return from the harvest.

Terms of the joint venture

31. Each of the Forestry Partnerships will enter into the JVA to facilitate the Collective Harvest and will accordingly be a joint venturer.
32. Under the JVA the Forestry Partnerships will agree to collectively harvest their forests. Conditions precedent to the commencement of the UJA are that:
- Each of the Forestry Partnerships will grant themselves a forestry right (Forestry Right) under the Forestry Rights Registration Act 1983 (FRR Act), which has the effect of separating the mature first rotation trees from the land on which the trees stand, as the joint venture is specific to the Collective Harvest of the trees. Clause 1 of the JVA states:
 - 1 Forestry Right**
 - 1.1 Creation of Forestry Right**

It is a condition precedent prior to this Agreement coming into effect that each Participant creates a forestry right in favour of the Participant over its own Land in respect of the Participant's Forest in accordance with section 2A of the Forestry Rights Registration Act 1983 and to register the forestry right against the title of the Participant's Land in accordance with the Land Transfer Act 1952.
 - 1.2 Form of Forestry Right**

The forestry right to be created under clause 1.1 shall be in the form set out in in Schedule 5.
 - 1.3 Variation or Surrender of Forestry Right**

No forestry right created under clause 1.1 may be varied, surrendered or transferred without the prior written consent of the other Participants.
 - Each of the Forestry Partnerships will execute an encumbrance (Encumbrance) that will be registered under the Property Law Act 2007 over that Forestry Partnership's Forestry Right in favour of the other five Forestry Partnerships to secure its obligations under the JVA. Clause 2 of the JVA states:
 - 2 Encumbrance**
 - 2.1 Encumbrance over Forestry Right**

It is a condition precedent prior to this Agreement coming into effect that each Participant executes and registers an encumbrance under the Property Law Act 2007 over that Participants' forestry right, in favour of the other Participants,

to secure performance of that Participant's obligations under this Agreement. The Manager will ensure that each Participant's authorised encumbrance is registered. Each Participant covenants that it will not permit any prior third party security interest to subsist in relation to the Participant's forestry right.

2.2 Form of Encumbrance

The encumbrance to be created under clause 2 shall be in the form set out in in Schedule 6.

33. Clause 3.2 of the JVA sets out the purpose of the joint venture as follows:

3.2 Purpose of Joint Venture

The purpose of the Joint Venture is to -

- (a) enable the Manager to undertake the harvest of all the Participant Forests as one integrated harvesting operation in order to maximise the financial return from harvest and minimise the risks associated with harvest for the shared benefit of the Participants ("Collective Harvest"); and to
- (b) undertake all business activities incidental to the Collective Harvest.

34. Clause 3.3 of the JVA sets out the joint venture interests (Percentage Share) of each of the Forestry Partnerships as follows:

3.3 Joint Venture Interests

The Joint Venture Interests of the Participants are -

Participant	Percentage Share
Glenwood Forest LP	17.3%
Goodwood Forest LP	14.9%
Homewood Forest LP	18.4%
Longwood Forest LP	15.1%
Majestic Pine Forest LP	16.0%
Millwood Forest LP	18.3%

35. Clause 3.4 of the JVA states that each Forestry Partnership retains ownership of their forest as grantee under that Forestry Partnership's Forestry Right:

3.4 Participants Scheme Property

Subject to clause 3.5, each Participant retains ownership of its Participant Forest as grantee under that Participant's forestry right subject to the encumbrance registered in terms of clause 2 for the benefit of the other Participants, and all other Scheme Property of that Participant's managed investment scheme whether those assets were acquired or accrued before or after the Commencement Date.

36. Clause 3.5 of the JVA states that each Forestry Partnership's ownership of their forest continues until the point of sale of the harvested logs by FEL, at which time the Forestry Partnership contributes the proceeds of sale of the logs to the UJV as "Joint Venture Property":

3.5 Participants Joint Venture Property

Each Participant's ownership of their Participant Forest as expressed in clause 3.4 continues until the point of sale of the harvested logs by the Manager at which time, the Participant contributes the proceeds of sale of the logs to the Joint Venture as Joint Venture Property.

37. The JVA defines "Joint Venture Property" as follows:

Joint Venture Property means any assets of the Joint Venture from time to time, and includes:

- (a) cash and amounts receivable;
 - (b) the proceeds of sale of harvest of all Participants' forests and all rights and receivables in respect of such proceeds;
 - (c) each encumbrance over the forestry right given by each Participant under clause 2.1; and
 - (d) choses in action which may give rise to a debt, revenue, claim or any other right or remedy under this Agreement,
- such assets to be held by the Participants as tenants in common according to each Participant's Percentage Share.

38. Clause 3.6 of the JVA states that all Joint Venture Property is held by the Forestry Partnerships as tenants-in-common in proportion to their joint venture interest:

3.6 Participants Entitlement to Joint Venture Property

All Joint Venture Property is held by the Joint Venture Participants as tenants in common in proportion to their Joint Venture Interest. Each Participant is entitled to its Percentage Share of the Joint Venture Property after deduction by the Manager of all Harvest Costs arising from the Collective Harvest. No Participant may claim that it has an entitlement to more than its Percentage Share of the Joint Venture Property after deduction of all Harvest Costs.

39. Clause 3.7 of the JVA states that each Forestry Partnership undertakes to allow FEL with full and unrestricted access to their land for the purpose of the joint venture:
- 3.7 Unrestricted Access for Collective Harvest**
- Each Participant undertakes to provide the Manager with full and unrestricted access to their Land and Participant Forest for the Purpose of the Joint Venture and authorises the Manager to construct all necessary roads and related infrastructure on the Participant's Land.
40. Clause 4 of the JVA sets out the relationship principles of the UJV as follows:
- 4 Relationship Principles**
- 4.1 Principles**
- The Participants recognise that the following relationship principles are important and intend these principles to guide them in their dealings with each other under this Agreement. All Participants are expected to observe the following principles at all times:
- (a) work together in good faith to enable the Joint Venture (through the Manager) to achieve the Purpose while recognising each other's separate business and investment interests;
- (b) work together cooperatively and constructively to give effect to the terms and conditions set out in this Agreement; and
- (c) observe high standards of integrity and fair dealing with each other.
- 4.2 Covenants**
- Each Participant covenants and agrees with the other Participants:
- (a) To diligently observe and perform its obligations and commitments in respect of the Joint Venture and pursuant to this Agreement;
- (b) To make their Participant Forest available for the Purpose of the Joint Venture.
41. Clause 5 of the JVA sets out the term (Term) of the joint venture as follows:
- 5 Term of Joint Venture**
- 5.1 Term**
- Unless the Participants unanimously agree otherwise, the Joint Venture shall commence on the Commencement Date and remain in effect until:
- (a) completion of Collective Harvest of the Participant Forests subject to the discretion of the Manager not to harvest any areas which do not contribute to the Purpose of the Joint Venture; and
- (b) distribution by the Manager of all the Joint Venture Property arising from the Collective Harvest to the Participants in their Percentage Shares after deduction of all Harvest Costs.
42. Clause 15 of the JVA states that the JVA concludes at the end of the Term:
- 15 Winding Up**
- 15.1 Winding Up at End of Term**
- This agreement concludes at the end of the Term.
43. Clause 6.1 of the JVA provides for the equitable treatment of any harvesting undertaken by any of the Forestry Partnerships prior to commencement of the JVA (noting that harvest may be required to commence before the JVA is practicably able to be executed):
- 6.1 Harvesting Prior to Commencement**
- The Participants agree that where harvesting has occurred in a Participant Forest prior to the commencement of this Agreement the Manager will adjust the payments and accounting for the Participant Shares such that at the earliest possible date following the Commencement Date the Percentage Share of each Participant will be correctly aligned.
44. Clause 8.1 of the JVA states that the agreement does not create or constitute a partnership between the Forestry Partnerships:
- 8 No Partnership**
- 8.1 No Relationship of Partnership or Agency**
- Nothing in this Agreement shall create or constitute or be deemed to create or constitute a partnership between the Parties, nor to constitute or create, or be deemed to create or constitute a Participant as an agent of any other Participant for any purpose whatsoever.

Terms of the Forestry Rights

45. Each of the Forestry Partnerships (as grantor) will grant themselves (as grantee) a Forestry Right under the FRR Act.
46. Schedule 5 of the JVA contains the terms and conditions of the Forestry Rights and relevantly provides:

WHEREAS:

- A. The Grantor is the registered proprietor of the Land described in Schedule 1.
- B. The Grantor wishes to create a forestry right in favour of itself over the area delineated on the plan in Schedule 3 (“the Forestry Block”) on the terms of this forestry right instrument.

...

1 GRANTEE’S RIGHTS

- 1.1 In consideration of the covenants and conditions on the part of the Grantee and the Grantor expressed or implied in this Forestry Right the Grantor transfers and grants to the Grantee for the term specified in Schedule 2 a Forestry Right within the meaning of the Forestry Rights Registration Act 1983 being the rights to:
- Manage, harvest, carry away, sell or otherwise utilise all mature (or soon to be mature) trees, timber and logs growing on the Forestry Block for the exclusive benefit of the Grantee.
 - Make install and use roadways, cableways, tracks, skids, gates, landings and other facilities on the Forestry Block (whether existing or otherwise) as may be necessary or convenient for the full enjoyment of this Forestry Right and leave the same in place at the end of the Term unless required to be removed pursuant to a resource or similar consent, or requested to be removed by the Grantor;
 - By itself or by its agents, employees, contractors, licensees and invitees from time to time enter and pass and repass on the Land with or without powered equipment and tools, machinery, vehicles and plant of all kinds.
 - Place and stack on any part of the Forestry Block as may be necessary or convenient any trees, timber or logs harvested pursuant to this Forestry Right.
 - Use any roadway on the Land for the purpose of the haulage of trees, timber and logs grown on the Forestry Block.
 - Generally, to do whatever the Grantee shall in its sole discretion determine may be necessary or convenient for obtaining the full benefits of the rights and privileges granted by this Forestry Right.
- 1.2 Roads and landings for the purposes of harvesting under this Forestry Right will be built at the sole discretion of the Grantee and to the standard the Grantee reasonably determines.
- 1.3 The Grantee shall be under no obligation on the expiry or termination of this Forestry Right to replant trees on the Forestry Block.
- ...
- 4 MUTUAL COVENANTS**
- 4.1 The rights agreed to be granted to the Grantee are expressly declared to be in the nature of a profit a prendre over the forest established on the Forestry Block.
- ...
- 4.3 The rights recorded in this document shall constitute a Forestry Right within the meaning of the Forestry Rights Registration Act 1983 and both the Grantor and the Grantee shall perform such acts as may be necessary to complete registration of this Forestry Right against the title to the Grantor’s land of which the Forestry Block forms part and to maintain registration until expiry or termination.

47. Prior to the transfer of the land to the new limited partnership both the grantor and the grantee of the Forestry Right will be the relevant Forestry Partnership.

Terms of the Encumbrances

48. Each of the Forestry Partnerships will execute an Encumbrance that will be registered under the Property Law Act 2007 over that Forestry Partnership’s Forestry Right in favour of the other five Forestry Partnerships.
49. Schedule 6 of the JVA sets out the terms and conditions of the Encumbrances which are contained in the Encumbrance Instrument which relevantly provides:

Encumbrancer

Goodwood Forest LP

Encumbrancee

Glenwood Forest LP

Homewood Forest LP

Longwood Forest LP

Majestic Pine Forest LP

Millwood Forest LP

Estate or interest to be encumbered

Forestry Right

...

Encumbrance

The Encumbrancer encumbers for the benefit of the Encumbrancees the Forestry Right in the above computer register(s) with the above sum of money, annuity or rent charge, to be raised and paid in accordance with the terms set out in the Annexure Schedule and so as to incorporate in this Encumbrance the terms and other provisions set out in the Annexure Schedule for the better securing to the Encumbrancees the payment(s) secured by this Encumbrance, and compliance by the Encumbrancer with the terms of this encumbrance.

...

ANNEXURE SCHEDULE**BACKGROUND**

- A. The Encumbrancer is the grantee under a Forestry Right registered against the Land.
- B. The Encumbrancer has entered into a Joint Venture Agreement dated [] with the Encumbrancees to enable collective harvest of the first rotation trees on the respective parcels of land over which the Encumbrancer and Encumbrancees have been granted Forestry Rights.
- C. The Encumbrancer enters into and registers this Encumbrance to secure its obligations under the Joint Venture Agreement.

COVENANTS AND CONDITIONS

...

2. Encumbrance

The Encumbrancer encumbers the Forestry Right for the benefit of Encumbrancees for a term of 20 years with an annual rent charge of \$10.00 to be paid on 1st June each year if demanded by that date. If, during the period preceding 1 June 2019 and each successive 12 months there shall have been no breach of the covenants contained in this Encumbrance, then the annual rent charge payable in respect of that twelve-month period shall be deemed to have been paid.

3. Covenants

The Encumbrancer acknowledges and covenants with the Encumbrancees that it will comply with its obligations under the Joint Venture Agreement.

4. Implied terms

- a. Sections 301 to 307 (inclusive) of the Property Law Act 2007 and section 154 of the Land Transfer Act 1952 shall apply to this Encumbrance.
- b. The Encumbrancees shall be entitled to the rights, powers and remedies given to encumbrancees by the Land Transfer Act 1952 and the Property Law Act 2007 except that the Encumbrancees shall not be entitled to the power of sale in Subpart 7 of Part 3 of the Property Law Act 2007.

5. First Charge

This Encumbrance shall rank as a first charge in respect of the Forestry Right and the Encumbrancer shall enter into a priority with any charge-holder or mortgagee to ensure that state of affairs.

6. Discharge

Under no circumstances shall the Forestry Right be released from the provisions of this Encumbrance unless any of the following occurs:

- (a) The Encumbrancees release the Encumbrancer by deed from the provisions of the Encumbrance;
- (b) The covenants expressed in this Encumbrance become obsolete; or
- (c) The covenants expressed in this Encumbrance are no longer enforceable.

For the avoidance of doubt the Encumbrancees agree to discharge the Encumbrance upon the occurrence of any of the events in (a) – (c) above.

Calculation of Collective Harvest Percentage Share

50. Income derived by the limited partners of the Forestry Partnerships from the sale of timber as part of the Collective Harvest will be based on each Forestry Partnership's share of the joint income (Percentage Share) received from the harvest for the year.
51. The underlying principle behind sharing the total revenue from the Collective Harvest is that the Forestry Partnerships will be better off receiving a Percentage Share of the total revenue from the Collective Harvest of the Emerald Hill Forests, rather than 100% of the revenue from the harvest of their individual forest.

52. The Percentage Share that each of the Forestry Partnerships will receive of the net harvest proceeds is calculated based on the relevant Forestry Partnership's "Forest Crop Value" (Forest Crop Value) - which is prescribed by *IAS 41: Agriculture* as it relates to biological assets. Each Forestry Partnership will agree to share the total revenue and expenditure from the Collective Harvest in accordance with the relevant Forestry Partnership's Forest Crop Value, as a percentage of the total Emerald Hills Forest, Forest Crop Value.

53. Specifically, the Percentage Share will be calculated as follows:

$$\text{Percentage share} = \frac{\text{Forest Crop Value of the relevant Forestry Partnership}}{\text{Total Forest Crop Value for all Forestry Partnerships}}$$

54. To illustrate, the table below estimates the Percentage Share for each of the Forestry Partnerships using approximate Forest Crop Values from September 2017:

Forest	Approx Forest Crop Value (Sept 2017)	Percentage Share
Goodwood	\$7,333,093	14.9%
Majestic Pine	\$7,880,138	16.0%
Millwood	\$8,979,432	18.3%
Glenwood	\$8,521,282	17.3%
Longwood	\$7,441,028	15.1%
Homewood	\$9,044,131	18.4%
	\$49,169,104	100.00%

55. The benefit of using Forest Crop Value is because the methodology is:

- Prescribed by *IAS 41: Agriculture*, the accounting standard for valuation of biological assets.
- Complies with the New Zealand Institute of Forestry valuation standard.

56. The final calculation will use a subset of each Forestry Partnership's projected cashflow (gross of tax) to which an appropriate discount rate will be applied.

57. In terms of the process used to come up with the Forest Crop Value, FEL will prepare the forestry and other inputs and enter these into each Forestry Partnership's cashflow to calculate the resulting shares for each Forestry Partnership in the joint venture. The assumptions for the forestry inputs are reviewed by the Forestry Auditor, and the cashflow amounts (being the calculated Forest Crop Value and the resulting shares of the Collective Harvest joint venture revenue) are reviewed by the Financial Auditor.

58. Following this, FEL will prepare and circulate a report to the investors to enable them to vote on the Collective Harvest joint venture proposal.

59. The key measure against which the calculated harvest shares is reported is a comparison with the percentage of net stocked areas of each Forestry Partnership in the joint venture. This is because, all other factors being equal, the percentage allocation of harvest to each Forestry Partnership should be the same percentage as the net stocked area. The differences in the calculated Percentage Shares is then explained and rationalised with reference to the actual hard data relating to valid actual differences between each Forestry Partnership's forest in the joint venture.

60. The expected timing of the Collective Harvest is a period of around nine to ten years. Accordingly, in each of those years, the Forestry Partnerships will harvest and dispose of timber to third parties. Each Forestry Partnership will be required to calculate and return their Percentage Share of the joint income arising from the sale of timber (net of their share of allowable deductions). Under the JVA, the Percentage Share of joint income and deductions for the year will be based on the respective Forestry Partnership's Forest Crop Value percentages.

61. The amount of the Percentage Share paid to each Forestry Partnership in a tax year will be a net amount after deduction by FEL of all Harvest Costs (as defined in the JVA) arising from the Collective Harvest.

Transfer of land

62. While the original Prospectuses only contemplated the land being planted and harvested once (ie, a single rotation), once the Collective Harvest has been completed it has been acknowledged that a replant of the areas harvested (the “cut over”) must occur for the following reasons:
- The consent received from the Gisborne District Council to harvest the mature trees requires the cut-over to be replanted within 18 months of harvest;
 - The Climate Change Response Act 2002 requires the forest areas defined as “Pre-1990 Forest” to be replanted in forest or the deemed pollution consequences (carbon emissions) accounted for and paid by the surrender of New Zealand Units (NZUs). The Forestry Partnerships do hold Pre-1990 Forests, and therefore if they are not replanted, NZUs would have to be surrendered; and
 - The value of the land is enhanced by replanting the second rotation as soon as possible – ie, the best and most economic land use is a crop of plantation Radiata pine trees, not the regrowth pine and weed species which will otherwise naturally regenerate.
63. This Collective Harvest may result in changes in the value and options available in respect of the underlying land which may favour certain Forestry Partnerships over others. This is because the Collective Harvest will affect the order in which the subsequent replant for the second rotation occurs.
64. To ensure all Forestry Partnerships are treated equitably, the land will be transferred at market value to a new limited partnership after the Forestry Rights have been granted, but before the Collective Harvest begins. The new limited partnership will grant rights of way over its land, which will authorise FEL passing over the land as required to complete the harvest.
65. The original investors are not required to participate in the second rotation planting. This is consistent with the expectation set out in the original Prospectuses (and in each Annual report), which prescribed that the investment can be wound up at the conclusion of harvest and the investors paid out in full.
66. This Ruling does not consider or rule on:
- the transfer of the Forestry Partnerships’ land to the new limited partnership and subsequent planting and harvesting of the second rotation tree crop on the land, or
 - the entry and exit of partners into and out of the new limited partnership.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- a) The creation of the Forestry Rights does not give rise to income for the limited partners of the Forestry Partnerships under s CB 24.
- b) The registration of Encumbrances over the Forestry Rights does not give rise to income for the limited partners of the Forestry Partnerships under s CB 24.
- c) The pooling of the Forestry Rights in the UJV does not give rise to income for the limited partners of the Forestry Partnerships under s CB 24.
- d) The Arrangement does not give rise to income for the limited partners of the Forestry Partnerships under s CB 25.
- e) Income from the disposal of timber as part of the Collective Harvest is derived by the Forestry Partnerships’ limited partners under s BD 3(2) during the year in which the proceeds from the disposal of the timber become due and payable to the Forestry Partnerships.
- f) Section GC 2 does not apply to the Arrangement.
- g) Section BG 1 does not apply to vary or negate the conclusions above.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 January 2018 and ending on 31 March 2028.

This Ruling is signed by me on the 27th day of November 2018.

Howard Davis

Director (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 18/07: Goods and services tax – zero-rating of services related to land

All legislative references are to the Goods and Services Tax Act 1985 (GSTA) unless otherwise stated. Relevant legislative provisions are reproduced in the appendix to this Interpretation Statement.

Scope of this statement

1. This Interpretation Statement concerns 1 April 2017 amendments to the GSTA. The amendments relate to the circumstances in which services related to land can be zero-rated under s 11A(1)(e) and (k).

Summary

2. Section 11A(1)(e) and (k) sets out circumstances in which land-related services can be zero-rated. As amended, s 11A(1)(k) provides that services supplied to non-residents who are outside New Zealand at the time the services are performed are eligible for zero-rating if they are not:
 - (a) directly in connection with land in New Zealand; or
 - (b) in connection with land in New Zealand and intended to enable or assist a change in the physical condition, ownership or other legal status of that land.
3. A corresponding rule in s 11A(1)(e) applies for services supplied in relation to land outside New Zealand.
4. This item sets out the Commissioner's interpretation of these provisions.

Introduction

5. Before 1 April 2017, s 11A(1)(e) and (k) provided that services related to land could be zero-rated in two situations. These services could be zero-rated where:
 - (a) "the services are supplied directly in connection with land situated outside New Zealand or any improvement to the land"; or
 - (b) the services are supplied to a non-resident who is outside New Zealand at the time the services are performed and where the services are not "supplied directly in connection with ... land situated in New Zealand or any improvement to the land".
6. Therefore, before 1 April 2017, the provisions asked whether the supply of services was "directly in connection" with land. The supply was zero-rated only if the services were:
 - (a) directly in connection with land outside New Zealand (para (e)); or
 - (b) **not** directly in connection with land in New Zealand and the recipient of the services was a non-resident and outside New Zealand at the time the services were performed (para (k)).
7. Section 11A(1)(e) and (k) was amended by the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017 with effect from 1 April 2017. This Act added a new test that broadened the variety of services zero-rated by para (e) and excluded from zero-rating by para (k). In each case, the relevant services now also include services that are:

supplied in connection with such land or improvement and are intended to enable or assist a change in the physical condition, or ownership or other legal status, of the land or improvement.
8. In other words, the provisions are no longer limited to services supplied "directly in connection" with land. Instead, services "in connection with land" are either included as zero-rated under para (e) or excluded from being zero-rated under para (k) if the services "are intended to enable or assist a change in the physical condition, or ownership or other legal status" of the land.

9. The commentary on the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Bill summarised the background to the changes (at p 72):

New Zealand's GST system is based on the destination principle, under which supplies of goods and services are taxed in the jurisdiction where the goods and services are consumed. This means services supplied to non-residents who are outside New Zealand will generally be zero-rated, as the services will be regarded as consumed overseas.

An exception is when the service supplied is so closely connected with land that the location of the land is the most appropriate place of taxation. Services supplied to non-residents who are outside New Zealand are not zero-rated when the services are directly in connection with land situated in New Zealand. Similarly, services that are supplied directly in connection with land situated outside New Zealand will be zero-rated (charged with GST at 0%).

10. This item discusses phrases used in s 11A(1)(e) and (k) both before those provisions were amended on 1 April 2017 (the prior provisions) and after (the amended provisions).

Analysis

11. The amended provisions are as follows:

11A Zero-rating of services

- (1) A supply of services that is chargeable with tax under section 8 must be charged at the rate of 0% in the following situations:

...

- (e) the services are supplied directly in connection with land situated outside New Zealand, or with an improvement to such land, or are supplied in connection with such land or improvement and are intended to enable or assist a change in the physical condition, or ownership or other legal status, of the land or improvement; or

...

- (k) subject to subsection (2), the services are supplied to a person who is a non-resident and who is outside New Zealand at the time the services are performed, not being services which are—

- (i) supplied directly in connection with land situated in New Zealand, or with an improvement to such land, or are supplied in connection with such land or improvement and are intended to enable or assist a change in the physical condition, or ownership or other legal status, of the land or improvement; or

...

12. Common terms and phrases are used in both paras (e) and (k) of s 11A(1). Much of the analysis that follows, therefore, applies to both provisions. However, the issues that arise under s 11A(1)(e) are essentially covered by the discussion of s 11A(1)(k). Therefore, the analysis focuses on para (k) and notes how any conclusions apply to para (e).

13. The analysis and examples in this item are structured in the following way:

- (a) The item first discusses the meaning of “non-resident” and the situations in which a non-resident will be regarded as “outside New Zealand at the time the services are performed”. These two preliminary elements are required by s 11A(1)(k) for that provision to apply.
- (b) The item then considers the types of interests that are “land” in the amended provisions. The item discusses this because services will be subject to the amended provisions only if they are directly in connection with land or in connection with land and intended to enable or assist certain changes to “land”.
- (c) The item then considers whether the services can be regarded as “directly in connection” with land. This test from the prior provisions is retained in the amended provisions.
- (d) For services that do not meet the “directly in connection” with land test, the item goes on to consider the application of the remainder of the amended provisions. This discussion covers:
- (i) whether services are “in connection with” land, as that test is the starting point for the application of the amended provisions;
- (ii) whether services enable or assist a relevant change to land and the types of services and the types of changes to land that are covered by the amended provisions;
- (iii) the circumstances in which services can be regarded as having been “intended” to enable or assist such changes.
- (e) Finally, the item briefly discusses ss 22 and 54B. Section 22 allows for input tax deductions to be claimed for pre-incorporation expenses. Section 54B allows some non-residents to register and claim input tax deductions for GST paid. Both ss 22 and 54B may provide input tax deductions where services are standard-rated under the amended provisions.

Section 11A(1)(k) – are the services supplied to a “non-resident” who is “outside New Zealand at the time the services are performed”?

“Non-resident”

14. For services to be zero-rated under s 11A(1)(k), they must be supplied to a person who is “non-resident”.
15. The term non-resident is defined in s 2 to mean “a person to the extent that the person is not resident in New Zealand”. Section 2 defines “resident” to mean resident in accordance with the income tax residency test in ss YD 1 and YD 2 (excluding s YD 2(2)) of the Income Tax Act 2007 (see the appendix). For individuals, the test depends on being present in New Zealand for a certain number of days or having a permanent place of abode in New Zealand. For companies, the test depends on the company’s place of incorporation, head office, centre of management and director control. For more information on “residence” under the Income Tax Act 2007, see “IS 16/03: Tax residence”, *Tax Information Bulletin* Vol 28, No 10 (October 2016): 2.
16. However, there are three modifications to the income tax residency tests. These modifications are in paras (a) to (c) of the definition of resident in the GSTA.
17. Paragraphs (b) and (c) of the definition relate to unincorporated bodies and the effect of the day count tests in the income tax residency tests. Paragraph (a) is particularly relevant in the context of supplies of land-related services. It provides that for GST purposes:

...a person shall be deemed to be resident in New Zealand to the extent that that person carries on, in New Zealand, any taxable activity or any other activity, while having any fixed or permanent place in New Zealand relating to that taxable activity or other activity...

Taxable activity or other activity

18. For para (a) of the definition of resident to apply, the person must carry on a “taxable activity or other activity”. The person’s taxable activity or other activity must also be carried on in New Zealand while the person has a “fixed or permanent place” in New Zealand relating to that taxable activity or other activity.
19. The term “taxable activity” is defined in s 6. The definition refers to an activity that is carried on continuously or regularly involving or intending to involve the making of taxable supplies. Notably, however, s 6(3) excludes certain activities from being taxable activities. Examples of excluded activities are activities that involve making exempt supplies (s 6(3)(d)) and hobbies (s 6(3)(a) and (aa)).
20. Paragraph (a) in the definition of “resident” also includes “other” activities in its scope. The terms “activity” and “other activity” are not defined in the GSTA.
21. The word “activity” is very broad. It may refer to “a course of conduct or series of acts which a person has chosen to undertake or become engaged in”: *Newman v CIR* (1994) 16 NZTC 11,229 (HC). Similarly, the Court of Appeal in *CIR v Bayly* (1998) 18 NZTC 14,073 said (at 14,078):

In its standard dictionary usage, “activity” is “the state of being active; the exertion of energy, action” (*Oxford English Dictionary*). In the context of ss 6 and 8 [of the GSTA] it points to the combination of tasks undertaken, or course of conduct pursued by the registered person and whether or not it amounted to a business, trade or profession in the ordinary sense.

22. Both *Newman* and *Bayly* discuss the meaning of “activity” in the context of the s 6 definition of “taxable activity”. The Commissioner’s view is that “activity” in “other activity” will bear the same meaning.
23. The inclusion of “other activity” in para (a) in addition to “taxable activity” was intended to expand the variety of activities that could result in residency under the GSTA. The legislative history confirms that “other activity” was included in para (a) to ensure supplies do not qualify for zero-rating where those supplies are made to non-residents whose activities involve the making of exempt supplies in New Zealand. An example is supplies made to a financial institution that is non-resident for income tax purposes (and thus may be non-resident for GST purposes but for the inclusion of para (a)).
24. However, the Commissioner’s view is that “other activity” is not limited to activities that involve the making of exempt supplies. The word “other” implies that Parliament intended that a wide variety of activities would be covered by para (a).

Fixed or permanent place

25. For para (a) in the definition of “resident” to apply, a person must also have a “fixed or permanent place” in New Zealand. The expression “fixed or permanent place” is not defined in the GSTA.
26. In the context of the provision, it is the place that must be “fixed” or “permanent”. The ordinary meaning of the word “place” indicates a physical location or a link to a particular geographical point.

27. The ordinary meaning of the words “fixed” and “permanent” indicates that the physical location must be lasting, unchanging and not temporary. An element of permanence is necessary, so a transient activity will not meet the test. However, ownership of the physical location is not necessary. Having a fixed or permanent place merely requires the person to have that place permanently at their disposal or be able to use that place on a permanent basis.
28. In the context of a supply of land-related services, it is necessary to consider whether the recipient has a “fixed or permanent place” and, therefore, whether the recipient might be a resident for GST purposes, at the time the services are supplied.
29. The Commissioner notes that a similar concept of “fixed establishment” is used in the Income Tax Act 2007, and the phrase “permanent establishment” is used in New Zealand’s double tax treaties. Case law has discussed the meanings of these phrases, and the concepts likely overlap with the concept of a “fixed or permanent place”.
30. However, the Commissioner’s view is that the “fixed establishment” and “permanent establishment” concepts are not equivalent to “fixed or permanent place” under the GSTA. The ordinary meaning of the word “establishment” is arguably a stronger term than “place”, so “place” may be wider in its scope. Also, tax treaties often define a “permanent establishment” to include or exclude specific types of establishments. In contrast, the GSTA definition is general in its terms.

Relating to

31. Paragraph (a) also requires the person to have a fixed or permanent place “relating to” the taxable activity or other activity.
32. Case law has considered the words “relating to” as well as the similar phrases “in relation to” and “in respect of”. The courts have said that the words “in respect of or in relation to” are “words of the widest import”: *Shell New Zealand Ltd v CIR* (1994) 16 NZTC 11,303.
33. In *New Zealand Forest Research Ltd v CIR* (1998) 18 NZTC 13,928, the High Court stated that the starting point in interpreting the meaning of “relating to” is to consider the ordinary and natural meaning of the phrase, in the context of the particular provision in which it is used.
34. The ordinary meaning of “relating” is a connection between things: *Concise Oxford English Dictionary*. This suggests that a degree of connection is required between the fixed or permanent place and the relevant activity.
35. The context of the provision does not appear to require a departure from the ordinary meaning of “relating to”. The provision is part of the definition of “resident” in the GSTA, which affects both the imposition of GST on supplies under s 8, and whether supplies can be zero-rated under the zero-rating provisions. In general, these provisions are intended to give effect to the destination principle, under which supplies of goods and services are taxed in the jurisdiction where the goods and services are consumed. Requiring a connection between a person’s activity in New Zealand and a fixed or permanent place in New Zealand before they are considered resident for GST purposes (and subject to GST at the standard rate) appears to be consistent with that purpose.

Example 1: Rental property owner resident for GST purposes

James, a non-resident for income tax purposes, owns a residential rental property in Wellington that he purchased in 2015. The property has been tenanted since James purchased it, with the tenants paying a weekly rent. On purchasing the property, James engaged a property manager to take care of day-to-day matters in relation to the property and the tenancy.

James’s residential rental activity is not a taxable activity under ss 6(3)(d) and 14. However, it will still be an “other activity” in terms of the s 2 definition of “resident”. This is because renting out a residential property on an ongoing basis is “a course of conduct or series of acts which a person has chosen to undertake or become engaged in” (Newman). Also, the phrase “other activity” in the s 2 definition of resident was intended to capture activities that would otherwise be exempt. Further, the rental activity is carried on from a fixed or permanent place, being the rental property.

This means James is treated as being a New Zealand resident for GST purposes to the extent of his rental activity.

To the extent that

36. For GST purposes, a person is deemed to be resident in New Zealand “to the extent that” the person carries on, in New Zealand any taxable activity or any other activity while having any fixed or permanent place in New Zealand relating to that taxable activity or other activity.
37. Similarly, the definition of “non-resident” in s 2 states that non-resident “means a person **to the extent that** the person is not resident in New Zealand” (emphasis added).

38. The use of the phrase “to the extent that” implies that a single legal person can, for the purposes of the GSTA, be both resident and non-resident. In the context of supplies of services, zero-rating applies only where goods are supplied to a non-resident. This means it may be necessary for a supplier to consider the extent to which the recipient is a resident or non-resident and whether the supply of services has been made to the recipient in their resident or non-resident capacity.

Example 2: A person may be both resident and non-resident

This example follows on from example 1. James is happy with his Wellington rental property. In 2017, he decides to look into acquiring a second property, but this time in Auckland. The property is to be used as premises for a coffee roastery business. As a foreign owner of the coffee business, James plans to hire a manager and staff to run the activity in New Zealand.

James has not yet settled on a property, but thinks three industrial areas in Auckland present good buying opportunities. He phones a property valuation firm to ask it to provide him with general valuation reports in relation to the three areas.

Although James is a resident for GST purposes under para (a) of the definition of “resident” in s 2, he is resident only “to the extent that” he carries on, in New Zealand, a relevant activity, while having any fixed or permanent place in New Zealand relating to that activity.

Any Auckland coffee roasting activity will constitute a separate activity from James’s Wellington rental property activity. Since James has not yet acquired a property in respect of the coffee roasting activity, he cannot be said to have a fixed or permanent place in New Zealand relating to the coffee roasting activity. Therefore, to the extent of the coffee roasting activity, James will be a non-resident for the purposes of the GSTA.

Since the valuation services supplied to James relate to his potential coffee roasting activities, those services are supplied to him in his non-resident capacity.

Whether general market valuation services can be zero-rated under s 11A(1)(k) is considered in example 18.

“Outside New Zealand at the time the services are performed”

39. Section 11A(1)(k) allows services to be zero-rated only when the non-resident recipient is “outside New Zealand” at the time the services are performed. However, two rules in s 11A provide that certain limited presences in New Zealand are treated as “outside New Zealand” for the purposes of the provision.
40. The first rule, in s 11A(3), relates to non-resident companies and unincorporated bodies. It provides that a non-resident company or unincorporated body will be treated as “outside New Zealand” if it has:
- (a) a minor presence in New Zealand; or
 - (b) for presences that are more than “minor”, a presence that is not “effectively connected” with the supply (where the ordinary meaning of “effectively connected” and the legislative history suggest a presence will not be effectively connected with a supply, if the presence cannot be regarded as actually or implicitly connected with the supply).
41. The second rule, in s 11A(3B), relates to natural persons. It provides that a natural person will be treated as outside New Zealand if they have:
- (a) a minor presence in New Zealand; and
 - (b) that minor presence is not “directly in connection with” the supply of services (“directly in connection with” is described from [51] and has the same meaning in the context of the rule for individuals in s 11A(3B), meaning, in general, that the presence is not directly related to the supply).
42. A person’s presence in New Zealand will be “minor” if it is a presence of short duration. Whether any given presence is minor will be a question of fact and depend on the circumstances of the particular case.

Example 3: Individual outside New Zealand

This example follows on from example 2. Unbeknownst to the valuer, James was attending a three-day origami convention in Queenstown when the valuation services were provided to him. James had arrived in Queenstown the night before the convention and flew out on the evening the convention closed.

Although James was physically present in New Zealand at the time the services were performed, s 11A(3B) treats his presence as being “outside New Zealand” for the purposes of s 11A(1)(k). This is because the short duration of James’s trip to New Zealand means it was a “minor presence”, and his “minor presence” was not directly in connection with the supply of services by the valuer because it was unrelated to his activities.

Example 4: Company outside New Zealand

C&C Pty Ltd is an Australian company that is non-resident for GST purposes. C&C is a leading producer of chalk and cheese in Australia. C&C also has a branch in New Zealand. The New Zealand operation focuses solely on chalk sales to schools and universities. C&C has a small office in Auckland, where two chalk sales staff are employed.

With whiteboards gaining in popularity, C&C's chalk sales are declining. C&C decides to investigate the possibility of extending its cheese business into New Zealand. To do so, C&C needs to consider acquiring New Zealand land to establish a cheese manufacturing plant.

C&C does not have a particular piece of land in mind, so commissions a report from a New Zealand valuation firm to establish the general prices of vacant commercially zoned land in several suitable regions in New Zealand.

Since C&C has a permanent office in Auckland, its presence in New Zealand is not short in duration. Therefore, C&C does not have a "minor presence" in New Zealand. However, under s 11A(3), C&C will still be regarded as being outside New Zealand at the time the valuation services were performed. This is because the services the valuation firm supplied are not "effectively connected" with C&C's presence in New Zealand. The services relate to C&C's possible expansion of its cheese business, but C&C's presence relates solely to its chalk sales operations.

What is "land" for the purposes of s 11A(1)(e) and (k)?

43. Paragraphs (e) and (k) of s 11A(1) apply to services intended to enable or assist a relevant change to "land" or "improvements".
44. The term "land" is defined in the GSTA only for the purposes of the compulsory zero-rating (CZR) of land rules. The Commissioner considers that in the context of s 11A(1)(e) and (k), "land" has a wide meaning and includes both physical land and legal and equitable estates in land.
45. However, the reference to "land" does not include a shareholder's interest in a land-owning company. This is because a land-owning company's shareholders have no interest, legal or equitable, in the land owned by the company (*R v McCurdy* [1983] NZLR 551 (CA)). Therefore, services that are intended to enable or assist a change in the ownership of a land-owning company's shares will not be regarded as enabling or assisting a change in the ownership of "land".
46. For completeness, the Commissioner notes that "land" does not include a licence to occupy land or other purely contractual right relating to land. However, even though such a contractual right itself may not be "land", it may still be able to be described as "directly in connection with" land – see para [69] below.
47. The term "improvement" is not defined in the GSTA. Based on case law, improvements to land include any work or operations done to land that enhance the value of that land (*Case L43* (1989) 11 NZTC 1,262; *Morrison v Federal Commissioner of Land Tax* (1914) 17 CLR 498 (HCA)).
48. Work done to a building may be improvements to land to the extent that it involves adding fixtures or making structural changes to the building. This is because, legally, a building and its fixtures are considered part of the land to which they are attached. This long-standing principle of land law is summarised in *Hinde, McMorland & Sim Land Law in New Zealand* (online looseleaf ed, LexisNexis, Wellington, accessed 3 August 2018) at [6.036]:

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

Are the services "directly in connection with" land?

49. Under the prior provisions, services related to land could be zero-rated where the services were supplied:
 - (a) "directly in connection with" land or improvements situated outside New Zealand; or
 - (b) to a non-resident who was outside New Zealand at the time the services were performed and where the services were not supplied "directly in connection with" land or improvements in New Zealand.
50. Under the prior provisions, a critical question was whether the services were "directly in connection with" land. That test has been retained in the amended provisions. Therefore, a supplier will still need to consider whether the services meet the "directly in connection with" test to determine whether the supply is zero-rated.

How the courts have interpreted "directly in connection with" land

51. Several cases discuss the phrase "directly in connection with" in the GST context. In particular, the phrase was considered in *Wilson & Horton Ltd v CIR* (1994) 16 NZTC 11,221 (HC), appealed as *Wilson & Horton Ltd v CIR* (1995) 17 NZTC 12,325 (CA), *Case S88* (1996) 17 NZTC 7,551 appealed as *CIR v Suzuki NZ Ltd* (2000) 19 NZTC 15,819 (HC) and *CIR v Suzuki NZ Ltd* (2001) 20 NZTC 17,096 (CA)), and *Malololailai Interval Holidays NZ Ltd v CIR* (1997) 18 NZTC 13,137 (HC). These cases illustrate how the phrase is to be interpreted in the context of s 11A(1)(k)(i).

52. In *Wilson & Horton* (HC), the issue was whether the supply of advertising space in a newspaper was “directly in connection with” the goods advertised. In the High Court, Hillyer J considered that the goods that were the subject of the advertising were not “directly in connection with” land or moveable personal property situated in New Zealand. Hillyer J said (at 11,224):
- The supply of space and the services rendered by Wilson & Horton are directly connected with the advertising but not with the goods advertised. The goods are, as it were, **at least one step removed** from the services supplied by the newspaper proprietor. [Emphasis added]
53. Hillyer J noted an example where services would and would not be directly in connection with goods (at 11,224):
- One example given by counsel was the painting of a vessel. That service would be directly in connection with the vessel, but services rendered to the passengers and crew of a vessel would not be rendered directly in connection with the vessel.
54. *Wilson & Horton* was appealed to the Court of Appeal. On appeal, the High Court’s conclusion that the services were not directly in connection with the advertised goods was accepted by both parties as correct. That aspect of the High Court’s judgment was not addressed by the Court of Appeal.
55. The legislation was amended to overturn the result in *Wilson & Horton*. The amendment was based on the Court of Appeal’s interpretation of the phrase “for and to”, which was previously contained in s 11(2)(e) (now s 11A(1)(k)). However, the phrase “directly in connection with” was retained in the provision. This arguably suggests that the “one step removed” test applied by the High Court in *Wilson & Horton* reflects the intention of the legislation.
56. Before the Court of Appeal’s decision in *Wilson & Horton*, a series of cases had commenced relating to the zero-rating of services supplied under certain vehicle warranty contracts: *Case S88* and *CIR v Suzuki NZ Ltd* (HC) and (CA) (collectively, the *Suzuki* cases).
57. In the *Suzuki* cases, a non-resident manufacturer (SMC), from whom an importer (SNZ) purchased vehicles, provided a service warranty to SNZ under which it agreed to reimburse SNZ for certain repairs. SNZ on-sold the vehicles to a dealer, which in turn sold the vehicles to the public. The warranty given by SNZ was wider than the warranty SNZ received from SMC. If SNZ was required to reimburse the dealer for the cost of repairs covered by SNZ’s warranty and the particular repairs were also within SMC’s warranty, SNZ would claim reimbursement from SMC.
58. In each of the *Suzuki* cases, the Commissioner argued, and the court agreed, that SNZ supplied vehicle repair services to SMC in return for the reimbursement payment. The issue was, therefore, whether the payment SNZ received from SMC was for services supplied “directly in connection with ... moveable personal property” (that is, the vehicles) in New Zealand.
59. On that issue, in *Case S88* Judge Barber said (at 7,558):
- There is a direct relationship or connection between the service of the repairs and the vehicle. Accordingly, the said “proviso” to s 11(2)(e) [relating to services directly in connection with moveable personal property in New Zealand] must apply to the facts of this case and prevent the objectors from relying on the zero-rating provisions of the s 11(2)(e). The repair service could not be performed but for the existence of the vehicle. The repairs were carried out for the objector (and others) which was carrying them out for MC (and others). The objector was not merely arranging for the repairs to be carried out, but was responsible under warranty to make the repairs — as was MC. That activity, or supply, meets the statutory nexus between goods and the service. The service is the actual repair of vehicles even though that work was performed by a contractor — usually the dealer.
60. *Case S88* was appealed to the High Court, where McGechan J said (at 15,830):
- I have no doubt that repair services were carried out directly in connection with moveable personal property situated in New Zealand at the time the services were performed. Quite simply, they were repairs carried out on cars within New Zealand. The situation equates to “painting the ship”. The nexus could not be closer.
61. And on appeal to the Court of Appeal, Blanchard J said (at 17,103):
- The repair services were obviously supplied in relation to goods, namely motor vehicles, which were situated in New Zealand. The supply of repairs could hardly be more directly connected with the motor vehicles.
62. *Malololilai Interval Holidays* involved a Fijian timeshare operation in which New Zealand purchasers bought a one-week per year licence to occupy an accommodation unit at a Fijian resort. The resort land was owned by an individual, but under a series of leases was leased to a Vanuatu company, referred to as MIH(V). A New Zealand company, MIH(NZ), acted as MIH(V)’s agent and entered into the timeshare agreements with purchasers. MIH(NZ) had made an agreement with another New Zealand company, AHL, under which AHL marketed the timeshares to purchasers. AHL was essentially responsible for concluding the timeshare agreements on behalf of MIH(NZ), including determining the sale price.
63. The issue was whether AHL’s marketing services were “directly in connection with land” outside New Zealand. If so, the services would be zero-rated under s 11(2)(b) (now s 11A(1)(e)).

64. Neazor J approached the issue by considering the transactions or supplies, and cited the Court of Appeal judgment in *Wilson & Horton* where Richardson J had said (at 13,146):
- [Section 8(1), the definitions of ‘taxable activity’ in s 6(1)(a) and of ‘supplier’ and ‘recipient’ in s 2 and ss 9(1) and 10(2)] **are directed to the contractual arrangements between the supplier and the recipient of the supply. In keeping with the general statutory scheme in that respect s 11, providing for zero rating of supply transactions where the stated overseas element is present, follows that same pattern.** It follows that where, as in the presently material s 11(2)(e), the provision refers to ‘services ... supplied ... to a person’ the statutory dictionary applies and the phrase refers to the contractual position and so to the person who has provided the consideration. [Emphasis added]
65. Neazor J went on to say (at 13,146):
- I would regard the contractual transaction between MIH(NZ) and the purchaser of an interval holiday as within the descriptive words “directly in connection with land or any improvement thereto”,** although that determination is not essential to this decision, but when attention is paid to the services supplied by AHL to MIH(NZ) [I] consider that those services are not within the statutory description. What AHL does is to advertise and promote interval holidays for MIH(NZ) and negotiate the contract for individual holidays (including the consideration for that contract between the purchaser and MIH(NZ)) up to the point where the contract is effected between those two parties.
- The services provided by AHL are not directly in connection with the land or the improvements. The transaction of those considered which would be in that category is the transaction between MIH(NZ) and the purchaser. **The transaction between AHL and MIH(NZ) is one which brings about the transaction which has direct effect, but in my view is of a kind to which Hillyer J’s words may properly be applied — it is one step removed from the direct transaction.**
- If one of the analogies referred to needs to be chosen I would take that of the publication of advertisements in the *Wilson & Horton* case. The newspaper proprietor’s services facilitated or opened the way to the transactions between vendor and purchaser, and that in my view is what [the marketing company AHL] did, although it was more closely involved in the transaction to which the statutory words apply than the publisher of an advertisement would be. Nevertheless **the transaction having direct effect** was not that of the publisher, or in this case of the sales agent. [Emphasis added]
66. Neazor J considered that the transaction between MIH(NZ) and the purchaser of an interval holiday was “directly in connection with” land outside New Zealand. However, he said that the marketing services supplied by AHL (although essential to bring together MIH(NZ) and the purchaser and closely related to the sale and purchase transaction) were not “directly in connection with” the land. This was because the marketing services transaction did not have a “direct effect” on land in the same way that the transaction between MIH(NZ) and the purchaser did.
67. *Malololailai* also confirms that the recipient of a service need not acquire a legal interest in land before the service can be “directly in connection with” the land. Neazor J commented (at 13,143):
- It is not in my view necessary to consider the first point of [the] argument further than that, because the issue is not whether the purchaser acquires land or an interest in land, but whether the services provided by the marketer on behalf of the objector are “directly in connection with land”, which may involve much less than acquiring an interest in the land. By way of example, the provision of gardening services would surely come within the statutory words.
68. For completeness, the phrase “directly in connection with” was also considered in *Auckland Regional Authority v CIR* (1994) 16 NZTC 11,080 (HC) and *Case T54* (1998) 18 NZTC 8,410. However, those decisions are not directly on point in the context of services related to land.

Directly in connection: summary of principles

69. The courts have generally interpreted the phrase “directly in connection with” narrowly. The following principles are derived from cases in relation to whether a service is directly in connection with property:
- The inclusion of the word “directly” in s 11A(1)(k) indicates that a close connection is required before a service is “directly in connection with” land (*Malololailai*).
 - Services may bring about or facilitate a transaction that has direct effect but, they are not services that are “directly in connection with” land or an improvement to such land if they are one step removed from the transaction that has direct effect (*Malololailai*, *Wilson & Horton*)
 - Services that involve a direct physical effect on land, such as repairs or gardening, will almost certainly be supplied directly in connection with land (*Malololailai*, *Wilson & Horton*).
 - Where a supply of services does not involve a direct physical effect on land, the courts may consider whether the supply of services has a direct legal effect on land. If the supply of services has a direct legal effect on land, such as a licence to occupy, the supply is likely to be directly in connection with land (*Malololailai*).
 - The recipient does not need to own, be entitled to use or have possession of the particular property for services to be directly in connection with that property (*Suzuki*).

- (f) It is not necessary that the supplier carries out the services personally for the supply to be directly in connection with land. It is possible for the supplier to act through an agent as happened in the *Suzuki* cases where it was the dealers that physically carried out the repairs.
- (g) Given the cases suggest that the test is one of fact and degree, a person does not physically need to go onto the land for their services to be directly in connection with land. Equally, the fact that a person does physically go onto the land while providing their services does not necessarily mean that those services will be directly in connection with land.

70. The examples from para [133] show how some of these principles will apply in practice.

Are the services “in connection with” land?

- 71. The new test expands the scope of the services covered to include services that are not only “**directly** in connection with” land, but are also “in connection with” land **and** of a certain nature (discussed further from [78]).
- 72. In *Case E84* (1982) 5 NZTC 59,441 at 59,446, Judge Bathgate discussed the meaning of the phrase “in connection with” in the context of the Income Tax Act 1976:

It is a matter of degree whether, on the interpretation of a particular statute, there is a sufficient relationship between subject and object to come within the words “in connection with” or not. **It is clear that no hard and fast rule can be or should be applied to the interpretation of the words “in connection with”. Each case depends on its own facts and the particular statute under consideration.**

...

Its proper interpretation depends on the context in which the phrase is used. It may mean “substantial relation in a practical business sense”, or it may have a far more restricted meaning, depending on its context ... [Emphasis added]

- 73. Judge Bathgate considered that it is a question of fact and degree and impression whether a sufficient relationship exists between two things for them to be “in connection with” each other. He held that the evaluation of whether two things are “in connection with” each other requires a common sense assessment of the factual situation.
- 74. In *Malololailai*, Neazor J referred to *Case E84* and said (at 13,144):

A good deal of the debate in that case about whether a narrow or wide interpretation of the statutory phrase was appropriate might have been seen as unnecessary if the word “directly” had been used, as it is in s 11 of the Goods and Services Tax Act 1985.
- 75. These comments highlight the difference in meaning between “directly in connection with” and “in connection with”. The word “directly” in s 11 is intended to narrow the scope of what might be considered to be “in connection with” the land and *Malololailai* confirms that the relevant services must have a direct physical or legal effect on the land.
- 76. In the context of s 11A(1)(e) and (k), the discussion at [51] to [69] notes that services that do not have a direct physical or legal effect on land are unlikely to be “directly in connection with” that land. But given the new test does not require a “direct” connection, a much wider variety of services will fall within the amended provisions. For instance, services that have only an indirect physical or legal effect – perhaps because they only facilitate a transaction that has a direct effect on land – are now captured.
- 77. However, it is important to note that not all services that meet the “in connection with” land test will meet the new test. The new test also requires the services to be “intended to enable or assist a change in the physical condition, or ownership or other legal status, of the land or improvement”.

Are the services intended to enable or assist a relevant change to land?

“Change” generally

- 78. For the new test to apply, services must be intended to enable or assist a “change” to land that is of a relevant type. The relevant types of changes covered by the new test are changes in the physical condition, ownership or other legal status of the land.
- 79. The word “change” is not defined in the GSTA. The ordinary meaning of the word “change”, in its noun form, is defined in the *Oxford English Dictionary* (online ed, accessed 3 August 2018):

An act or process through which something becomes different.
- 80. In the context of the new test, the ordinary meaning, therefore, suggests that a “change” will involve an “act or process” where the physical condition, ownership or other legal status of the land “becomes different”. As explained at paras [109] to [119], a “change” of this sort only needs to be intended by the recipient, even if it does not result.

81. In some instances, services might relate to a specific piece of land in New Zealand, but might not be capable of being described as being intended to cause the physical condition, ownership or other legal status to “change” in the way described above. The Commissioner’s view is that these services will not be covered by the new test.

Example 5: Inherited land

Poppy, who lives in the United Kingdom and is not a New Zealand tax resident, inherits some New Zealand land from a relative. The land is a vacant lot. Following the inheritance, Poppy engages a New Zealand law firm to advise her on the legal obligations associated with owning the specific lot of inherited land in New Zealand (for example, rates and insurance) and what restrictions (if any) apply to the use or uses to which the land may be put.

The services supplied to Poppy do not relate to the change in ownership of the land on inheritance. The law firm’s advice is about the implications of holding land unchanged, not about changing the land’s physical form, ownership or other legal status.

Since the new test is directed at services that “change” the land in a relevant way, the services are not subject to the new wording and may be zero-rated.

A change in the physical condition of land

82. A change in the “physical condition” of land is the first kind of change covered by the new test.
83. Services that have a direct effect on the physical condition of land are generally captured under the “directly in connection” test. Two examples of such services are construction work and earthworks. Where the relevant land is New Zealand land, this means the services are standard-rated.
84. However, before the amendments, services that did not have a direct physical effect on land were not always captured, even if they, for instance, facilitated services that had a direct physical effect. The amendments provide that generally these kinds of services are now also standard-rated. Examples of typical services that enable or assist a change in the physical condition of land are:
- (a) architectural services;
 - (b) engineering;
 - (c) construction supervision.

A change in the ownership or other legal status of land

85. Another relevant change is a change in the ownership of land. The word “ownership” is not defined in the GSTA. The *Concise Oxford English Dictionary* (12th ed, Oxford University Press, Oxford, 2011) defines “own”:
- Own** ... v. 1 possess; have. ...
86. The *Butterworth’s New Zealand Law Dictionary* (6th ed, LexisNexis, Wellington, 2005) defines “ownership” as:
- The right to the exclusive enjoyment of a thing. Ownership may be absolute, in which case the owner may freely use or dispose of his or her property, or restricted, as in the case of joint ownership. Beneficial ownership is the right of enjoyment of property, as distinguished from legal ownership.
87. Therefore, to “own” an item of property, the ordinary meaning is that a person must possess or have the exclusive enjoyment of that item of property. Ownership can be absolute or restricted.
88. Case law suggests that “ownership” generally refers to legal rights unless the context demands otherwise. In *Bellinz Pty Ltd v FCT* (1998) 98 ATC 4,399 the Australian Federal Court said (at 4,411):
- Ultimately ownership consists of *rights* over property. Accordingly, unless the legal or natural meaning is displaced by the context in which the issue of ownership arises a legal or jurisprudential, rather than a commercial or popular, analysis of these rights is required. [Emphasis in original]
89. As above, “ownership” is context specific but is likely to refer to a legal concept involving exclusive enjoyment of property. However, the provisions do not refer to “ownership” in isolation. Section 11A(1)(e) and (k) uses a composite phrase “ownership or other legal status”.
90. The phrases “legal status” and “other legal status” are not defined in the GSTA nor are they used in any other provision. But in the context of the new test, the phrase used is “ownership or other legal status”. This implies “ownership” is a subset of “legal status”. It also implies that the term “other legal status” must cover a wider variety of legal statuses than ownership.

91. The *Oxford English Dictionary* (online edition, accessed 3 August 2018) defines the words “legal” and “status” as:
- legal**, adj.
- 1 Relating to the law.
- status**, n.
- 2 The situation at a particular time during a process.
92. Based on the ordinary meaning, the phrase “other legal status” refers to a status arising under the law. When considering the ways in which status is granted under the law, it is useful to go back to the context of the amended provisions to see that the phrase “ownership or other legal status” refers to “land or improvements to land”. Therefore, the context is that the amended provisions are concerned with legal status as it relates to land and improvements.
93. The Commentary to the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Bill provides some assistance in determining the meaning of “ownership or other legal status” (at 71):
- The inclusion of services intended to “enable or assist a change in the ... ownership or other legal status of the land” is expected to apply to a variety of professional services such as legal or real estate agents’ services as part of a land transaction, where the ultimate outcome is to change the legal nature of the land but the services do not involve any physical change or connection to the land.
94. That commentary states that a “variety of professional services” and services that change the “legal nature” of the land are intended to be covered by the new test.
95. The concepts of “legal status” and “legal nature” appear to refer to interests in land that a person might have and that are recognised in law. A limited number of interests in land give rise to “legal statuses”. These statuses may be created in different ways, take a variety of different forms, and arise under common law or statutory rules. For instance, the legal status of land may depend on whether the land is subject to an interest such as a lease, a life interest, an easement or a mortgage.
96. Some interests may be able (or required) to be registered against the title to the land and some may not. As an example, a short-term lease as defined in s 207 of the Property Law Act 2007 is not able to be registered but gives rise to an interest in land (*Hinde McMorland & Sim Land Law in New Zealand* (online looseleaf ed, LexisNexis, Wellington, accessed 3 August 2018) at [11.038]). Therefore, the ability to be registered will not be determinative of the existence of an interest in land and so a “legal status” for the purposes of the new test.
97. Legal interests can be contrasted with interests such as licences. A licence is generally accepted as being a personal right against the licensor (see, for instance, *Hinde McMorland & Sim Land Law in New Zealand* (online looseleaf ed, LexisNexis, Wellington, accessed 3 August 2018) at [18.001]). It is not a right in the land that can be enforced against a third party, nor is it one that can be registered against the title. In that sense, the Commissioner’s view is that the grant of a licence does not change the “legal status” or “legal nature” of land.
98. Changes in equitable interests in land can also give rise to changes in the ownership or other legal status of land. This means services that, for instance, enable or assist the sale of an equitable interest in a property purchased “off the plans” may enable or assist a relevant change to land.
99. Certain services relating to changes to land-owning trusts are similarly covered by the amended provisions.
100. In the context of a beneficial interest in land, the entitlements of a beneficiary stem from the terms of the trust deed and the exercise of discretions by the trustees. As a result, the nature of a beneficiary’s interest in trust property varies accordingly.
101. Although each situation will depend on the terms of the trust deed, the Commissioner’s view is that in the context of a land-owning discretionary trust, a discretionary beneficiary is unlikely to have an interest in “land” for the purposes of the provisions. This is because, generally, a discretionary beneficiary has no more than a hope that the trustee’s discretion will be exercised in his or her favour (*Law of Trusts* (LexisNexis, Wellington, 2018) at [4.68], citing *Re Munro’s Settlement Trusts* [1963] 1 All ER 209 (Ch)). This means services that, for instance, add or remove individual beneficiaries to or from a land-owning discretionary trust are unlikely to enable or assist a change in the ownership or other legal status of land.
102. Where the trust relationship means a beneficiary has an interest in the trust’s land, as may be the case for a fixed trust, services that alter the interests of beneficiaries may enable or assist a change in the ownership or other legal status of land.
103. Where services involve trust deed changes that are intended to enable or assist changes in a legal interest in land, they will enable or assist a change in the ownership or other legal status of land. For instance, services that are intended to change the trustees of a land-owning trust will result in a change in the person holding a legal interest in that land. Therefore, the services are intended to enable or assist a change in the ownership or other legal status of land.

104. Where the trust deed changes do not involve any changes in trustees' or beneficiaries' interests, the services are unlikely to enable or assist a change in the ownership or other legal status of land. Typical services falling into this category might be changes to the administrative provisions of the deed (for instance, provisions regarding trust meetings).
105. Consequently, the Commissioner's view is that the phrase "a change in ownership or other legal status of land" is referring to two different things:
- (a) changes in ownership of any estate or interest in land, including legal and equitable interests; and
 - (b) other changes in the legal status of any estate or interest in land, such as granting a lease, a life interest or an easement or registering a mortgage as security against the title to land, but excluding changes in personal or contractual rights such as licences.
106. The following are examples of services that enable or assist a change in the ownership or other legal status of land:
- (a) Typical services provided by a lawyer or real estate agent in a sale and purchase of real estate. This will be the case whether the sale is of a legal interest in land or an equitable interest in land (such as where the sale is of an interest in a property that was purchased "off the plans").
 - (b) Services involved in arranging a lease of land.
 - (c) Legal services relating to transactions involving the mortgage of land.
 - (d) Services provided to alter the trustees of a trust where the trust property includes land.
 - (e) Services provided to alter the beneficiaries of a fixed trust where the trust property includes land.
 - (f) Services provided to create, alter or remove an easement that grants certain rights in relation to a person's land. For example, services provided to a landowner to assist them in obtaining an easement so they can lay a drain across their neighbour's land.
 - (g) Services that are intended to procure a change relating to land in terms of a district plan or regional plan made under the Resource Management Act 1991.
 - (h) Accounting and tax services supplied as part of a land transaction where those services can be said to be intended by the recipient to enable or assist a change in the ownership or other legal status of land. This could be where:
 - (i) accounting or tax advice is required as a formal condition of the sale agreement; or,
 - (ii) the accounting or tax advice can be regarded as being intended to enable or assist a relevant change such as where the advice assists the recipient in their choice of business structure in the context of a land purchase. The specific facts will need to be considered in each case.
107. The following are examples of services that are unlikely to enable or assist a change in the ownership or other legal status of land:
- (a) Services provided to change the shareholders of a land-owning company.
 - (b) Services provided to alter a discretionary trust's beneficiaries where the trust property includes land.
 - (c) General year-end accounting and tax services, such as the preparation of accounts or tax returns for a property for a non-resident client.
 - (d) Accounting and tax services supplied following the conclusion of a land transaction. For instance, where those services assist a client with making the correct accounting entries to record the past transaction in their accounting records. Or where the accounting or tax advice is advice as to how the accounting or tax rules applied to a past transaction.

Services that "enable or assist" a relevant change

108. The amended provisions cover services in connection with specific land only where the services are intended to "enable or assist" certain changes to that land. Services that "enable or assist" a relevant change will be services intended to help or make possible a relevant change. In some cases, services may be in connection with specific land and relate to a change in the physical condition, ownership or other legal status of the land, but may not "enable or assist" such a change.

Example 6: Services where there is a lack of intention to “enable or assist” a relevant change

Bev, a non-resident, owns a vacant section of land in New Zealand. Bev’s land is adjacent to another vacant section owned by T-Shirts Ltd. Bev discovers that T-Shirts is proposing to build a t-shirt factory on its land. The factory development of T-Shirts is expected to carry some risk of degrading the quality of Bev’s land.

Bev engages a New Zealand law firm to advise on her right to object to the proposed factory development by T-Shirts.

Although the law firm’s services arguably relate to a change in the physical condition of a specific piece of land in New Zealand, the services cannot be said to be intended to “enable or assist” that change. The services are not intended by Bev to help or make possible the proposed development of the factory.

What is the “intended” purpose of the services?

109. Where services are “in connection with land”, it is also necessary to determine what the services are intended to achieve. This is because services are captured by the new test in the amended provisions only if they are “intended” to enable or assist certain changes to land.
110. In the context of s 6(1)(a), the Taxation Review Authority in *Case N27* (1991) 13 NZTC 3,229 followed the Court of Appeal’s reasoning in *Grieve v CIR* (1984) 6 NZTC 61,682 in finding that a person’s intention is a subjective matter, but that the person’s stated intention can be tested against objective evidence. The Commissioner’s view is that a similar approach is required in the new test. The “intended” purpose of the services is, therefore, determined by considering the recipient’s subjective intention against the wider factual circumstances.
111. The amended provisions do not explicitly state whose intention is to be tested. However, in the context of the amended provisions, the Commissioner’s view is that the recipient’s intention is relevant.
112. The evidence that suppliers should hold to establish the recipient’s intention will depend on the nature and context of the services. Since the test is subjective (but tested objectively), in some cases it may be useful for the supplier to obtain some form of statement from the recipient. However, it may not be necessary to obtain a statement in all cases, such as where the documentary evidence is clear as to what the services were intended to do.
113. If the recipient refuses to or does not provide the required information about their intention for the services acquired, it is recommended the supplier standard-rates the transaction, unless the supplier is confident that zero-rating is the correct GST treatment of the supply. By standard rating the supply in this situation the supplier ensures that any GST payable for the supply is accounted for by the supplier at the appropriate time. If it is subsequently found that the supply should have been zero-rated, then the GST paid can be corrected.

Example 7: Keeping evidence to show whether services enable or assist a relevant change

Frank is a non-resident owner of a Rotorua residential property. Frank has not owned the property long and does not have any plans for the property. However, Frank’s friend recently sold a property on the same street for more than she had expected. Frank wonders whether his property may also have gained in value.

Frank emails Valerie, a valuer, and asks her to produce a valuation report for his property. He outlines the situation above in the email. Valerie carries out the valuation and sends Frank the valuation report.

The services will be zero-rated under s 11A(1)(k). When Valerie invoices Frank, she wonders what evidence she will need to show Frank’s intention. There is no reason for Valerie to think that Frank’s intention is anything other than as he has stated in his email. In the absence of any reason to think otherwise, Valerie retains a copy of the email as evidence of Frank’s intention.

Forming an intention

114. Since a person’s intention is a subjective matter (but objectively tested), the Commissioner’s view is that services will not be zero-rated by s 11A(1)(e) or standard-rated (by being excluded from zero-rating) by s 11A(1)(k) until the recipient has formed a subjective intention that the services supplied are to enable or assist a relevant change.
115. In terms of whether such an intention has been formed, the recipient’s stated intention will be important evidence. However, consistent with the approach to ascertaining a person’s intention described above, stated intentions can be tested against relevant objective evidence.
116. Whether the recipient has formed the requisite intention with respect to the services is particularly relevant where the services might be preliminary to services intended to enable or assist a relevant change. Services that are preliminary to services intended to enable or assist a relevant change may not be captured by the amended provisions.

Example 8: Decision not to make an offer

Braxton Ltd is a non-resident for GST purposes and a potential bidder in a competitive tender situation in relation to a specific piece of New Zealand land. Braxton is undecided whether it will make an offer in the tender, as it seems a land covenant may cause problems with the land. Braxton suspects the covenant could prevent it from carrying on certain activities on the land.

Braxton, therefore, engages a New Zealand law firm to assist with some preliminary investigative work (including advising on the covenant, Overseas Investment Office and Resource Management Act 1993 issues). The law firm's advice is that the covenant is highly restrictive and will prevent Braxton from using the land in the way that it would like.

Because of the advice, Braxton decides not to make an offer.

The law firm bills its clients monthly. It takes about four months for Braxton to carry out the investigative work in relation to the possible purchase before deciding that it will not make an offer. Therefore, by the time the decision is made, the law firm has sent four months' worth of tax invoices to Braxton in respect of the services it has supplied.

The supplies will be zero-rated under s 11A(1)(k). This is because Braxton had not yet formed a relevant intention in accordance with the amended provisions; that is, an intention that the services are to enable or assist a change in the ownership of the land.

Example 9: Decision to make an offer

This example follows on from example 8. Braxton Ltd decides, in principle, to make an offer to purchase a different parcel of land. However, before submitting the offer, Braxton requires assistance from the New Zealand law firm to prepare the tender documents. Braxton also decides that to formulate the precise terms of its offer, it needs further information from a New Zealand engineering expert.

The services the law firm and the engineering expert supply will be standard-rated under s 11A(1)(k). This is because Braxton has formed a relevant intention, so the services can be said to be intended to enable or assist a change in the ownership of the land. These services will be standard-rated irrespective of whether the tender is successful.

Example 10: Indistinct intention

A New Zealand law firm is engaged to advise Atticus Ltd, a non-resident company, about a proposed acquisition of a New Zealand business, where the transaction could be completed by way of either a share sale or an asset sale. The assets of the target business are predominantly land.

Atticus engages the law firm to provide legal services for the acquisition. The legal services include conducting due diligence regarding the assets (including the land), negotiating and drafting the asset sale agreement, attending to settlement, and providing legal and tax advice about the structure to be used to hold the assets and operate the business.

The decision whether the transaction is to be implemented through a share sale or an asset sale will be made after due diligence and at least one round of commercial negotiations.

The law firm bills its clients monthly. It takes about four months for Atticus to carry out due diligence in relation to the purchase before deciding that it intends to acquire the assets of the New Zealand business rather than the shares. Therefore, by the time the decision is made that the assets will be acquired, the law firm has sent four months' worth of invoices to Atticus for the services it has supplied.

The supplies will be zero-rated under s 11A(1)(k). Atticus had not yet formed a relevant intention in accordance with the amended provisions; that is, an intention that the services are to enable or assist a change in the ownership of the land. As explained in [45], in the context of the provisions, a change in the ownership of a land-owning company is not equivalent to a change in the ownership of land.

After Atticus has decided to purchase the assets of the New Zealand business, the law firm's services will be standard-rated.

Frustrated intention

117. Assuming all other requirements in the new test are met, where a person has formed a relevant intention under the new test, the services will be zero-rated by s 11A(1)(e) or standard-rated by s 11A(1)(k).
118. This is important because sometimes services may have been intended to enable or assist a relevant change to the land, but that change may not eventuate. An example of this might be where a tender is submitted for the purchase of the land, but the tender is unsuccessful.
119. Provided that the recipient intended that the services would enable or assist a relevant change, the new test will apply. The relevant change to the land does not need to occur in fact or as a result of the provision of the services.

Example 11: Frustrated intention

This example follows on from example 9. Six months earlier, Atticus Ltd had identified a different piece of New Zealand land that it considered an attractive investment opportunity.

Atticus decided in principle to proceed with a tender offer on the land. Atticus engaged the same New Zealand law firm to advise on the offer and help it to prepare the offer documents. The law firm also assisted Atticus with Overseas Investment Office and Resource Management Act 1993 issues.

Atticus made a bid, but it was unsuccessful.

The law firm's services will not be zero-rated under s 11A(1)(k). This is because the law firm's services are in connection with land and Atticus intended that the law firm's services would enable or assist a change in the ownership of the land, even though that did not occur.

Multiple intentions

120. Sometimes the services may have more than one intended result. A question arises as to which intention is relevant. For instance, a New Zealand supplier may supply a variety of services in undertaking an assignment for a non-resident. Some of these services may be intended to enable or assist a change in "ownership ... of the land" (as those words are used in s 11A(1)(k)) and some may be intended to enable or assist a change in the ownership of property other than land.
121. The first step is to consider whether there is a single supply of services or multiple supplies of services. The Commissioner's view about how that issue should be analysed is set out in "IS 17/03: Goods and services tax – single supply or multiple supplies", *Tax Information Bulletin* Vol 29, No 4 (May 2017): 102. IS 17/03 states that the transaction should be considered from the recipient's point of view to determine whether there is a "single composite supply" or separate supplies of different elements.
122. If the services that enable or assist a change in ownership of the land can be severed from the other services on a reasonable basis, the approach described in IS 17/03 is to apply zero- or standard-rating to each supply as appropriate. If the supply of services cannot be severed on a reasonable basis, there is a single composite supply.
123. Section 5(14) can separate zero- and standard-rated elements of a single composite supply into multiple supplies. However, the Commissioner's view in IS 17/03 is that there will be a separation under s 5(14) only where the relevant zero-rating provision (that is, a provision of s 11A) allows for apportionment. IS 17/03 follows the Commissioner's view on the zero-rating of part of a supply in "IS 08/01: GST – Role of section 5(14) of the Goods and Services Tax Act 1985 in regard to the zero-rating of part of a supply", *Tax Information Bulletin* Vol 20, No 5 (June 2008): 8.
124. The words of s 11A(1)(e) and (k) do not contemplate apportionment. Because of this, the Commissioner's view is that the correct approach from IS 17/03 is that the GST treatment of the supply will follow the dominant element of the supply. If there is no dominant element (for example, the supply is made up of several equally important elements that are integral to each other), the GST treatment will be determined by the overall characteristics of the single composite supply.
125. For a more detailed discussion on how to treat single or multiple supplies, suppliers should consult IS 17/03.

Example 12: Services intended to enable or assist a change of ownership of land and non-land assets

Paul's Water Storage Ltd, a non-resident company, has decided to expand into New Zealand by acquiring the business assets of Felix's Tanks Ltd, a New Zealand tank-manufacturing company. The asset acquisition includes land, plant and machinery, business contracts, goodwill, an inventory of tanks, and intellectual property.

Paul's Water Storage engages a New Zealand legal firm to provide legal services for the acquisition. Such legal services include negotiating and drafting the asset sale agreement, attending to settlement, and providing legal and tax advice regarding the structure to be used to hold the assets and operate the business.

"IS 17/03: Goods and services tax – single supply or multiple supplies", Tax Information Bulletin Vol 29, No 4 (May 2017): 102 requires the law firm to consider the supply of services from the recipient's point of view to determine whether there is a "single composite supply" of services or separate supplies of different elements. From the perspective of Paul's Water Storage, the recipient of the legal services, it wants all of the legal services required to enable it to purchase the business. On this basis, the services are not able to be severed into separate supplies on a reasonable basis. Additionally, s 5(14) will not separate the supply into zero- and standard-rated components because s 11A(1)(k) does not contain words of apportionment.

For the purposes of this example, assume that the value of the land is 20% of the total value of the business, and that this also reflects a reasonable apportionment of the supply of services.

Following "IS 17/03, whether the entire supply is zero- or standard-rated, therefore, turns on whether the dominant element of the supply is services that enable or assist a relevant change to land. In this example, an apportionment on a reasonable basis suggests only 20% of the services relate to land and the remaining 80% of the services relate to the acquisition of non-land assets. Since the dominant element in the supply is not land-related services, the supply of services will be zero-rated.

"BR Pub 15/03: Goods and services tax - legal services provided to non-residents relating to transactions involving land in New Zealand"

126. Before the new test, the Commissioner issued "Public Ruling BR Pub 15/03: GST – legal services provided to non-residents relating to transactions involving land in New Zealand", *Tax Information Bulletin* Vol 27, No 3 (April 2015): 4. The public ruling applies to the prior provisions that have been retained in the new test. The ruling concludes that certain legal services are not "directly in connection with" land or improvements to land; rather they are one step removed from the transaction that has a direct effect on the land or are ancillary to that transaction.

127. Following the enactment of the amended provisions, the legal services described in BR Pub 15/03 will generally be standard-rated under s 11A(1)(k) because the legal services will enable or assist a relevant change in the land. Suppliers will no longer be able to rely on the ruling because s 91G of the Tax Administration Act 1994 provides that:

- [a] binding ruling does not apply from the date a taxation law is repealed or amended to the extent that the repeal or amendment changes the way the taxation law applies in the ruling.

When can a non-resident claim input tax deductions?

128. For completeness, two other provisions in the GSTA may allow for input tax deductions.

129. The first provision is s 54B, which allows some non-resident suppliers to register for GST and claim input tax deductions for GST they have been charged. Section 54B is intended to ensure only final consumers are subject to GST. It may be relevant if a non-resident has been charged GST on a supply of land-related services because those services cannot be zero-rated under s 11A(1)(k).

130. To register under s 54B, the non-resident must be registered for a consumption tax in their home country or, if their home country does not have a consumption tax, must be carrying on a taxable activity and be making a sufficient level of supplies that would render them liable to be registered under the New Zealand GSTA. If s 54B applies, the non-resident can register for GST and claim input tax deductions for the GST imposed on land-related services.

131. The second provision is s 22, which relates to pre-incorporation costs. Some non-residents might receive land-related services on behalf of a company that is yet to be formed. This might occur where a non-resident intends to incorporate a New Zealand subsidiary to hold the land. If the non-resident were to do this, s 22 might become relevant and allow the New Zealand subsidiary an input tax deduction for GST charged under s 11A(1)(k). For that to happen:

- (a) the non-resident would need to become a "member" of the New Zealand subsidiary (s 22(a));
- (b) the non-resident would need to be reimbursed by the New Zealand subsidiary for the whole amount of the consideration paid for the services (s 22(a));

- (c) the New Zealand subsidiary would need to acquire the services only for the purpose of its taxable activity (s 22(b));
 - (d) the supply of the services by the non-resident to the New Zealand subsidiary cannot be a taxable supply (this seems unlikely to occur in practice) (s 22(c))
 - (e) the acquisition of the goods and services would need to occur within the six months before the New Zealand subsidiary was incorporated (s 22(d)); and
 - (f) sufficient records would need to be held (s 22(e)).
132. Assuming the above requirements are met, s 22 would deem the recipient of the supplies to be the New Zealand subsidiary. It would also deem the time of supply to be during the period in which the reimbursement was made. That would allow the New Zealand subsidiary to claim an input tax deduction (provided it is registered).

Further examples

133. The following examples help to explain how the law applies.

Example 13: Gardening services

Dave, a non-resident for income tax purposes, owns a residential property in Wellington that he purchased in 2016. Dave intends to retire to New Zealand in about five years' time. Since Dave acquired the property it has been vacant. Dave does not own any other properties in New Zealand. He lives permanently overseas and rarely visits New Zealand. Dave engages Graham to carry out maintenance work on the property. Graham visits the property every three weeks to mow the lawns and tend to the gardens.

Dave is a non-resident for GST purposes. This is because, although the residential property might be a fixed or permanent place in New Zealand, Dave has left the property vacant. Because the property has been left vacant, Dave is not carrying on a taxable activity or any other activity in New Zealand.

Since Dave is a non-resident who is outside New Zealand, s 11A(1)(k) can apply to zero-rate the services, unless the services are "directly in connection" with land, or "in connection with ... land ... and are intended to enable or assist a change in the physical condition, or ownership or other legal status, of the land".

The lawn-mowing and gardening services Graham provides are directly in connection with land as they have a direct physical effect on the land. Therefore, they will not qualify for zero-rating under s 11A(1)(k).

Example 14: Valuation services

This example follows on from example 13. After one year of ownership of the Wellington property, Dave decides to get the property valued as he is interested to know its market value. Dave does not intend to use the valuation for any purpose other than to inform himself of the value of the property. Dave engages Rich's Consultants Ltd, a property consultancy firm, to provide him with the valuation.

The valuation services can be zero-rated. This is because the valuation services are not "directly in connection with" land, since they do not have a direct legal or physical effect on land. The services are not covered by the new test because they are not intended to enable or assist a relevant change to the land.

Example 15: Surveying services

This example follows on from example 14. Dave's Wellington house is on a relatively large section. The house is at the front of the section, and there is an access way to the rear of the land. The valuation from Rich's Consultants Ltd, tells Dave that the value of his property has increased. Dave decides that, instead of keeping the whole section, an option might be to subdivide the land and sell the back section. He thinks that on his retirement he is unlikely to need all the land. However, he is still undecided about the subdivision. Dave wants to make sure that having neighbours close by will not interfere with his lifestyle.

Dave asks Rich's Consultants to investigate the possibility of a subdivision. He asks Rich's Consultants to survey the land and determine the boundaries for a subdivision.

The surveying services can be zero-rated. This is because the surveying services are not "directly in connection with" land, since they do not have a direct legal or physical effect on the land. Since Dave has not yet decided to proceed with any subdivision or sale of the back section, the surveying services are not "intended" to enable or assist a relevant change under the new test.

Example 16: Developing the property

This example follows on from example 15. Dave decides to go ahead with the subdivision. To maximise the value of the property, he thinks it would be best to build a house on the back section and then sell the house and land together. Dave hires an architect to draw up plans for a house. He also hires a building company to undertake the earthworks and construction work, and a construction supervisor to oversee the development.

The architecture services and the supervisory services are not directly in connection with land. This is because, unlike the earthworks and the construction work, they do not have a direct legal or physical effect on the land. However, the architecture and supervisory services are in connection with land and intended to enable or assist a change in the physical condition of the land, so must be standard-rated.

The earthworks and construction work are directly in connection with land as they have a direct physical effect on land, so they must be standard-rated.

Example 17: Real estate agent and lawyer's services

This example follows on from example 16. Dave hires a real estate agent to market the house and land on his behalf. The real estate agent carries out the advertising and negotiation and receives a commission on the sale of the property. Dave also engages a lawyer to take care of the legal aspects of the sale.

The services the real estate agent supplies are not directly in connection with land, because the services do not have a direct legal or physical effect on land. The same conclusion applies to the legal services. However, both the real estate agent's services and the legal services are in connection with land and are intended to enable or assist a change in the ownership of the land, so they must be standard-rated.

Example 18: Services relating to a transfer of an equitable interest in land

Paris is a non-resident who lives in Sydney. Paris enters into an agreement for sale and purchase 'off the plans' for an apartment in a block to be developed in Auckland. The agreement for sale and purchase is conditional and will not become unconditional until the block receives a code compliance certificate, which is not expected to happen for another 12 months.

For some time, Paris has also had her eye on her 'dream home' in Sydney. Three months later, Paris discovers that the property in Sydney has been listed for sale. However, the asking price is such that Paris cannot afford to buy both properties.

Paris decides that she cannot forego the opportunity to buy her dream home and decides to sell her interest in the Auckland apartment to another buyer who will complete the transaction. To sell her interest, Paris engages an Auckland-based real estate agent to market her interest in the property. She also engages a lawyer to advise her on the legal aspects of the transaction.

Paris's interest in the apartment is an equitable interest in the land. Paris no longer intends to complete the purchase of the apartment and gain legal title. Paris now intends only to acquire and dispose of the equitable interest. Therefore, the services the real estate agent and lawyer supplied are in connection with land and intended to enable or assist a change in the legal status of the land.

The Commissioner's view is that the new test applies to services intended to enable or assist a change in an equitable interest in land. The services the real estate agent and lawyer supplied will, therefore, be standard-rated under s 11A(1)(k).

Example 19: valuation services for multiple properties

Sarah, a non-resident living outside New Zealand, is interested in purchasing a rental property in New Zealand.

To understand the market prices in various regions, Sarah asks a valuer to provide her with general reports outlining the prevailing values of four-bedroom properties in certain suburbs of Auckland, Wellington and Christchurch.

Since the services do not relate to specific land in New Zealand, the services the valuer supplies are not directly in connection with land nor are they intended to enable or assist a relevant change to land. Therefore, the services can be zero-rated.

Sarah finds 10 properties of interest to her on the internet. To understand the market prices for those properties, Sarah orders computer-generated valuation reports for each of the 10 properties from a website. She pays a fee to the website for the reports.

The valuation services supplied to Sarah in relation to the 10 properties relate to specific land in New Zealand but do not have a direct legal or physical effect on the land. The valuation services are, therefore, not “directly in connection with” land. The valuation services do not meet the new test since the services cannot be said to be intended by Sarah to enable or assist a relevant change to any particular property. Therefore, the services can be zero-rated.

Table on GST treatment of particular services relating to specific land in New Zealand

134. The GST treatment depends on whether the services are **directly** in connection with land, **or** are in connection with land **and** are intended to enable or assist a change in the physical condition or ownership or other legal status of the land (relevant intended change). A relevant intended change is not needed for services directly in connection with land. However, sometimes both the “directly in connection with land” alternative and the “in connection with land” with the relevant intended change alternative will be satisfied.
135. The following table provides examples of particular services relating to specific land in New Zealand and the GST treatment of the services under s 11A(1)(k). The table gives examples for services provided to a person who is a **non-resident for GST purposes** and who is outside New Zealand at the time the services are performed. The table is not intended to be exhaustive.

Examples of services relating to the physical condition or ownership or other legal status of land in New Zealand	Intended to enable or assist a change to the land	GST treatment	Relevant example in this item
Accounting services - intended to enable or assist a change to the land	Yes	Standard-rated	
Accounting services - not intended to enable or assist a change to the land	No	Zero-rated	
Advertising services for a land transaction	Yes	Standard-rated	
Architectural services for specific land	Yes	Standard-rated	Example 15
Construction on specific land	Yes	Standard-rated	Example 15
Construction supervision for specific land	Yes	Standard-rated	Example 15
Earthworks on specific land	Yes	Standard-rated	Example 15
Engineering for specific land	Yes	Standard-rated	Example 8
Gardening on specific land	Yes	Standard-rated	Example 12
Legal services for a land transaction	Yes	Standard-rated	Examples 8, 10, 11, 16 and 17
Legal services – not intended to enable or assist a change to the land	No	Zero-rated	Examples 5, 6, 7 and 9
Property management for specific land	Yes	Standard-rated	
Real estate services for a land transaction	Yes	Standard-rated	Examples 16 and 17
Surveying of specific land	Yes	Standard-rated	
Surveying – not intended to enable or assist a change to the land	No	Zero-rated	Example 14
Valuation services for specific land	Yes	Standard-rated	

Examples of services relating to the physical condition or ownership or other legal status of land in New Zealand	Intended to enable or assist a change to the land	GST treatment	Relevant example in this item
Valuation services – not intended to enable or assist a change to the land	No	Zero-rated	Example 13
Valuation services for the general market	No	Zero-rated	Example 18
Valuation services for part of the market	No	Zero-rated	Example 18

References

Subject references

goods and services tax
GST
land
services
zero-rating

Case references

Auckland Regional Authority v CIR (1994)
16 NZTC 11,080 (HC)
Bellinz Pty Ltd v FCT (1998) 98 ATC 4,399 (FC)
Case E84 (1982) 5 NZTC 59,441
Case L43 (1989) 11 NZTC 1,262
Case N27 (1991) 13 NZTC 3,229
Case S88 (1996) 17 NZTC 7,551
Case T54 (1998) 18 NZTC 8,410
CIR v Suzuki NZ Ltd (2000) 19 NZTC 15,819 (HC)
CIR v Suzuki NZ Ltd (2001) 20 NZTC 17,096 (CA)
CIR v Bayly (1998) 18 NZTC 14,073 (CA)
Grieve v CIR (1984) 6 NZTC 61,682 (CA)
Malololailai Interval Holidays NZ Ltd v CIR (1997)
18 NZTC 13,137 (HC)
Morrison v Federal Commissioner of Land Tax (1914)
17 CLR 498 (HCA)
Munro's Settlement Trusts, Re [1963] 1 All ER 209 (Ch)
Newman v CIR (1994) 16 NZTC 11,229 (HC)
R v McCurdy [1983] NZLR 551 (CA)
Wilson & Horton Ltd v CIR (1994) 16 NZTC 11,221 (HC)
Wilson & Horton Ltd v CIR (1995) 17 NZTC 12,325 (CA)

Legislative references

Goods and Services Tax Act 1985, ss 2 (definitions of “non-resident”, “resident”), 5(14), 6, 11A, 14, 22, 54B
Income Tax Act 1976
Income Tax Act 2007, ss YD 1 and YD 2
Property Law Act 2007, s 207
Resource Management Act 1991
Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017

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“IS 08/01: GST – Role of section 5(14) of the Goods and Services Tax Act 1985 in regard to the zero-rating of part of a supply”, *Tax Information Bulletin* Vol 20, No 5 (June 2008): 8.
“IS 16/03: Tax residence”, *Tax Information Bulletin* Vol 28, No 10 (October 2016): 2.
“IS 17/03: Goods and services tax – single supply or multiple supplies”, *Tax Information Bulletin* Vol 29, No 4 (May 2017): 102.
Law of Trusts (LexisNexis, Wellington, 2018).
Oxford English Dictionary (online ed, accessed 3 August 2018).
“Public Ruling BR Pub 15/03: GST – legal services provided to non-residents relating to transactions involving land in New Zealand”, *Tax Information Bulletin* Vol 27, No 3 (April 2015): 4.
Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Bill: Commentary on the Bill (Inland Revenue, Wellington, 2016, available from taxpolicy.ird.govt.nz/publications/2016-commentary-archcrm/overview).

Appendix – Legislation

Goods and Services Tax Act 1985

1. Section 11A(1)(e) and (k) provides:

(1) A supply of services that is chargeable with tax under section 8 must be charged at the rate of 0% in the following situations:

...

(e) the services are supplied directly in connection with land situated outside New Zealand, or with an improvement to such land, or are supplied in connection with such land or improvement and are intended to enable or assist a change in the physical condition, or ownership or other legal status, of the land or improvement; or

...

(k) subject to subsection (2), the services are supplied to a person who is a non-resident and who is outside New Zealand at the time the services are performed, not being services which are—

(i) supplied directly in connection with land situated in New Zealand, or with an improvement to such land, or are supplied in connection with such land or improvement and are intended to enable or assist a change in the physical condition, or ownership or other legal status, of the land or improvement; or

(ii) supplied directly in connection with moveable personal property, other than choses in action or goods to which paragraph (h) or (i) applies, situated in New Zealand at the time the services are performed; or

(iii) the acceptance of an obligation to refrain from carrying on a taxable activity, to the extent to which the activity would have occurred within New Zealand; or

2. The definition of “non-resident” in s 2 provides:

non-resident means a person to the extent that the person is not resident in New Zealand

3. The definition of “resident” in s 2 provides:

resident means resident as determined in accordance with sections YD 1 and YD 2 (excluding section YD 2(2)) of the Income Tax Act 2007: provided that, notwithstanding anything in those sections,—

- (a) a person shall be deemed to be resident in New Zealand to the extent that that person carries on, in New Zealand, any taxable activity or any other activity, while having any fixed or permanent place in New Zealand relating to that taxable activity or other activity;
- (b) a person who is an unincorporated body is deemed to be resident in New Zealand if the body has its centre of administrative management in New Zealand;
- (c) the effect of the rules in section YD 1(4) and (6) of that Act are ignored in determining the residence or non-residence of a natural person, and residence is treated as—
- (i) starting on the day immediately following the relevant day that triggers residence under section YD 1(3) of that Act; or
- (ii) ending on the day immediately following the relevant day that triggers non-residence under section YD 1(5) of that Act

Income Tax Act 2007

4. Section YD 1 provides:

YD 1 Residence of natural persons

What this section does

(1) This section contains the rules for determining when a person who is not a company is a New Zealand resident for the purposes of this Act.

Permanent place of abode in New Zealand

(2) Despite anything else in this section, a person is a New Zealand resident if they have a permanent place of abode in New Zealand, even if they also have a permanent place of abode elsewhere.

183 days in New Zealand

(3) A person is a New Zealand resident if they are personally present in New Zealand for more than 183 days in total in a 12-month period.

Person treated as resident from first of 183 days

(4) If subsection (3) applies, the person is treated as resident from the first of the 183 days until the person is treated under subsection (5) as ceasing to be a New Zealand resident.

Ending residence: 325 days outside New Zealand

(5) A person treated as a New Zealand resident only under subsection (3) stops being a New Zealand resident if they are personally absent from New Zealand for more than 325 days in total in a 12-month period.

Person treated as non-resident from first of 325 days

(6) The person is treated as not resident from the first of the 325 days until they are treated again as resident under this section.

Government servants

(7) Despite subsection (5), a person who is personally absent from New Zealand in the service, in any capacity, of the New Zealand Government is treated as a New Zealand resident during the absence.

Presence for part-days

(8) For the purposes of this section, a person personally present in New Zealand for part of a day is treated as—

- (a) present in New Zealand for the whole day; and
- (b) not absent from New Zealand for any part of the day.

...

Treatment of non-resident seasonal workers

(11) Despite subsection (3), a non-resident seasonal worker is treated for the duration of their employment under the recognised seasonal employer (RSE) instructions as a non-resident.

5. Section YD 2 provides:

YD 2 Residence of companies*Four bases for residence*

(1) A company is a New Zealand resident for the purposes of this Act if—

- (a) it is incorporated in New Zealand;
- (b) its head office is in New Zealand;
- (c) its centre of management is in New Zealand;
- (d) its directors, in their capacity as directors, exercise control of the company in New Zealand, even if the directors' decision-making also occurs outside New Zealand.

International tax rules

(2) Despite subsection (1), for the purpose of the international tax rules, a company is treated as remaining resident in New Zealand if it becomes a foreign company but is resident in New Zealand again within 183 days afterwards.

Cook Islands National Superannuation Fund trustee

(3) Despite subsection (1), the trustee of the Cook Islands National Superannuation Fund, established by the Cook Islands National Superannuation Fund Deed under the Cook Islands National Superannuation Scheme Act 2000 (Cook Islands), is not a New Zealand resident.

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 18/15: GST - when will goods and services supplied in connection with the repatriation of human remains from New Zealand be zero-rated?

As part of our review of Public Information Bulletins, this QWBA updates and replaces PIB 168 "GST on Human Remains for Repatriation" (January 1988: 5).

Question

When will goods and services supplied in connection with the repatriation of human remains from New Zealand be zero-rated?

Answer

Services supplied in connection with the repatriation of human remains (such as cremation and embalming services) will be zero-rated where:

- The services are supplied to a non-resident who is outside New Zealand when the services are performed; and
- The remains will not be received by a third party in New Zealand (and it was not reasonably foreseeable when the contract was entered into that a third party would receive the remains in New Zealand).

Goods (such as caskets and urns) exported by the supplier are zero-rated.

Explanation

1. All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.
2. *Public Information Bulletin* (PIB) 168 "GST on Human Remains for Repatriation" (January 1988: 5) stated that work performed on human remains to be repatriated overseas could not be zero-rated. The reason given was that human remains are "moveable personal property" situated in New Zealand when the services are performed. The Commissioner is now of the view that this is not correct and, in certain circumstances, the goods and services can be zero-rated.

When services can be zero-rated

3. The relevant provision in this context is s 11A(1)(k) (which is subject to s 11A(2)). For the types of services being considered, s 11A(1)(k) will apply where:
 - the services are supplied to a non-resident;
 - the recipient is outside New Zealand when the services are performed;
 - the services are not supplied directly in connection with land in New Zealand;
 - the services are not supplied directly in connection with moveable personal property; and
 - the performance of the services will not be received in New Zealand by a third party (and it is not reasonably foreseeable at the time the agreement is entered into that the performance of the services will be so received).
4. These requirements are considered below.

Services supplied to a non-resident outside New Zealand

5. The services will be supplied to a non-resident if the contract for services is entered into with a non-resident.
6. As well as being a non-resident, that person must be "outside New Zealand" at the time the services are performed. For a non-resident company or unincorporated body, "outside New Zealand" includes a minor presence in New Zealand, or a presence that is not effectively connected with the supply (s 11A(3)).
7. For a natural person, "outside New Zealand" includes a minor presence in New Zealand that is not directly in connection with the supply.

Services not supplied directly in connection with land in New Zealand

8. Services supplied “directly in connection with land” are not able to be zero-rated. Certain services provided “in connection with land” are also unable to be zero-rated; however, these are unlikely to be relevant in this context.
9. In the context of the repatriation of human remains, it is unlikely that any of the services provided would be directly in connection with land. However, if instead of repatriating the remains, the funeral home arranges for burial in New Zealand, that service would be directly in connection with land. Consequently, it would not be zero-rated.

Services not supplied directly in connection with moveable personal property in New Zealand

10. Services are not able to be zero-rated if they are supplied directly in connection with moveable personal property situated in New Zealand. PIB 168 stated that work performed in New Zealand by funeral directors on human remains that are to be repatriated could not be zero-rated because the services are performed on moveable personal property (being the human remains) which are in New Zealand when the services are performed. The correctness of this has been questioned.
11. “Property” is relevantly defined in the *Concise Oxford English Dictionary* (12th ed) as “a thing or things belonging to someone” and “ownership”. There is case law considering whether there is “property” in a dead body.
12. In *Takamore v Clarke* [2011] NZCA 587; [2012] 1 NZLR 573, the Court of Appeal considered who had the right to determine where a body would be buried. In the course of the judgment the Court discussed the issue of whether there is property in a body (footnotes omitted):

[199] At common law an executor has the duty to dispose of the body of the deceased. The application of this common law duty has not been modified by statute in New Zealand. Section 24 of the Administration Act 1969 states that all of the estate of a deceased person vests in the administrator of the estate. This provision does not alter the clear common law position that **the estate does not include the body of the deceased**, and that the obligation to dispose of the body is an obligation imposed under the common law.

[200] **It is generally accepted that there is no property in the body of a deceased.** However, as the executor has the duty to dispose of the body of the deceased, he or she therefore has the right to possession of the deceased’s body for the purpose of final disposal. The right to possession of the dead body is directed towards the ancillary duty of ensuring a proper burial, providing an exception to the “no property in a dead body” rule.

[Emphasis added]

13. Similar observations were made in *Re JSB (A Child)* [2010] 2 NZLR 236 (HC). And in *Public Trustee v Kapiti Coast Funeral Home Ltd* [2004] 3 NZLR 560 (HC), the Court stated:

[11] Some discussion of the law as to rights and duties in relation to a dead body is desirable as background to the analysis of liability for funeral expenses. **At common law, there is no property in a deceased body, and a person cannot by will dispose of his or her dead body** – *Williams v Williams* (1882) 20 Ch D 659 at p 665. There is no statutory provision which would modify this position in New Zealand.

[Emphasis added]
14. Therefore, under the common law, there is no property in a dead body. There are no statutes that change this as a general proposition. In the Commissioner’s view, as there is no property in a human body, the body cannot be property. No one can own a body and a body cannot belong to anyone. If a body cannot be property, it follows that it cannot be “moveable personal property”. As such, services provided in connection with a human body will not be excluded from zero-rating under s 11A(1)(k)(ii).

Performance of the services will not be received in New Zealand by a third party

15. Section 11A(2) will apply to prevent zero-rating where the performance of services will be received in New Zealand by a third party (ie, not the contractual recipient of the services). Section 11A(2) will also apply where it is reasonably foreseeable at the time the agreement is entered into that the performance of the services will be received in New Zealand by a third party (regardless of whether this, in fact, occurs).
16. In the Commissioner’s view, a person will receive the performance of cremation or embalming services where they take possession of the remains. The performance of the services will not be received in New Zealand if the remains are exported overseas by the funeral home.
17. In some cases a service will be held in New Zealand before the repatriation. In the Commissioner’s view, performance of the associated services (venue hire, celebrant etc) will be received in New Zealand by those attending the service and cannot be zero-rated. In the Commissioner’s view these services will generally be separate supplies from the supply of embalming or cremation services. However, if there is any uncertainty, the principles to be applied are set out in Interpretation Statement IS 17/03 “Goods and Services Tax – Single Supply or Multiple Supplies” (*Tax Information Bulletin* Vol 29, No 4 (May 2017)).

When goods can be zero-rated

18. The main goods that could be supplied in relation to the repatriation of human remains are caskets and urns. The standard rules for zero-rating exported goods in s 11 apply. Section 11(1)(a)-(e), 11(4) and 11(5) are particularly relevant.
19. In summary, the supply of goods will be zero-rated where they have either been exported (by the supplier) or will be exported (by the supplier) in the course of, or as a condition of, making the supply. The applicable time period for exporting goods is 28 days from the time of supply (or a longer period that the Commissioner has allowed).
20. The following examples are included to assist in explaining the application of the law.

Example 1 – Relative in New Zealand contracts for repatriation services

21. Sally and John moved to New Zealand 10 years ago when they retired. However, when the time comes, both want to be buried in England where they were born. When John dies, Sally contracts with ABC Funeral Home (ABC) to have John embalmed and his remains repatriated to England.
22. The services provided by ABC are standard-rated as Sally is a New Zealand resident and is in New Zealand when the services are performed. The sale of the casket to transport John's body will be zero-rated if it is exported by ABC.

Example 2 – No presence in New Zealand

23. Sally (from Example 1) dies a year later. Sally's sister Edith from Liverpool arranges for a Liverpool funeral home to contract with ABC to repatriate Sally's remains. ABC performs the embalming, obtains the necessary permits and documentation, and repatriates Sally's remains to England.
24. The services provided by ABC are zero-rated as the contract is entered into with a non-resident. Also, the services are not received by the third party in New Zealand. The sale of the casket to transport Sally's body will also be zero-rated as it is exported by ABC.

Example 3 – Performance of services received in New Zealand

25. Sid is on holiday from Perth when he dies while travelling around New Zealand. Sid's travel insurance provider contracts with ABC to have Sid cremated. Sid's wife Penny flies to New Zealand to collect Sid's ashes from ABC and fly home with them.
26. The services provided by ABC are standard-rated as the performance of the services is received in New Zealand by Penny. The sale of the urn to carry Sid's ashes is also standard-rated as it is not exported by ABC.

Example 4 – Person in New Zealand not receiving performance of the services

27. Mario and Luca are travelling in New Zealand when Mario dies. Mario's travel insurance provider (a UK resident) contracts with ABC to have Mario embalmed and his remains repatriated to Scotland. ABC performs the embalming, obtains the necessary permits and documentation, and repatriates Mario's remains to Scotland.
28. Luca remains in New Zealand throughout the process and arranges to fly home on the same flight as Mario's body.
29. The services provided by ABC are zero-rated. The contract is entered into with a non-resident (the insurance company) who has no presence in New Zealand. Also, although Luca is in New Zealand while the services are being performed and accompanies Mario's body on the flight home, he does not receive the performance of the services in New Zealand. The sale of the casket to transport Mario's body will also be zero-rated as it is exported by ABC.

Example 5 – Funeral services performed in New Zealand

30. Margaret has been living in New Zealand for the past 20 years. When she dies her brother from Canada contracts with ABC to organise a small funeral service for Margaret so that her friends can say goodbye. Following the service, Margaret's body will be cremated and her ashes sent back to Canada.
31. The services in relation to the funeral are standard-rated as their performance is received in New Zealand by Margaret's friends. The cremation services are zero-rated as no one receives the performance of those services in New Zealand (the remains are sent back to Margaret's brother in Canada). The sale of the urn is also zero-rated as it is exported by ABC.

References

Subject references

Funeral services
Goods and Services Tax
GST
Human remains
Repatriation

Legislative references

Goods and Services Tax Act 1985: ss 11(1)(a)–(e), (4) and (5), 11A(1)(k), 11A(2), and 11A(3).

Case references

Public Trustee v Kapiti Coast Funeral Home Ltd [2004] 3 NZLR 560 (HC)
Re JSB (A Child) [2010] 2 NZLR 236 (HC)
Takamore v Clarke [2011] NZCA 587; [2012] 1 NZLR 573

Other references

PIB 168 “GST on Human Remains for Repatriation” (January 1988: 5)
IS 17/03 “Goods and Services Tax – Single Supply or Multiple Supplies” *Tax Information Bulletin* Vol 29, No 4 (May 2017).

QB 18/16: Income tax — bright line test — main home exclusion — sale of subdivided section

This Question We've Been Asked (QWBA) explains when a section subdivided from a residential property sold within the bright-line period will be excluded from the bright-line test. It will be of interest to sellers seeking to rely on the main home exclusion.

Question

When is the sale of a section subdivided from a residential property sold within the bright-line period excluded from the bright-line test?

Answer

The sale is excluded when the main home exclusion applies.

The main home exclusion will apply when:

- more than 50% of the area of the land in the subdivided section has been used for a dwelling that was the seller's main home; and
- the seller has used the land in the subdivided section in that manner for more than 50% of the time since the seller acquired the undivided land.

Key Terms

Bright-line period: The bright-line period is 2 years or 5 years, depending on the rules in place when the seller acquired the land.

Bright-line test: The bright-line test applies to tax sales of residential land occurring within the bright-line period.

Curtilage: An area of land attached to a dwelling and forming one enclosure with it, such as a yard or garden.

Subdividing: Subdividing involves the legal division of land into multiple sections and the creation of new legal titles for each section.

Explanation

The bright-line test

1. The bright-line test taxes residential land sold within the bright-line period.
2. This bright-line test applies to residential land that a person first acquired an interest in on or after 1 October 2015. The period of the bright-line test increased from 2 years to 5 years for residential land that a person first acquired an interest in, on or after 29 March 2018 (see s 6(2) of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018). Therefore, this QWBA refers to the "bright-line period" (which will be 2 years or 5 years, depending on when the seller first acquired an interest in the land).

Scope of this QWBA

3. This QWBA is about whether the main home exclusion to the brightline test can apply in a situation where:
 - there is undivided land which contains a dwelling (which is the seller's main home);
 - the land is subdivided into new sections, one which contains the dwelling and another (or others) which does not contain a dwelling; and
 - the subdivided section (or one of the sections) without a dwelling is sold.
4. Under the main home exclusion, if residential land has been used predominantly for a dwelling that is the seller's main home and used in this manner for most of the time the seller has owned the land, then the sale of that land within the bright-line period is excluded from being taxed under the bright-line test.
5. In this QWBA, it is assumed that none of the other land rules in ss CB 6 to CB 12 of the Income Tax Act 2007 apply to the sale of the subdivided section, eg s CB 6, which applies to the sale of land acquired for the purpose of re-sale. The bright-line test needs to be considered only where the sale is not taxed under any of the other land rules in ss CB 6 to CB 12.
6. Additionally, for simplicity this QWBA assumes that the person disposing of the land is not the trustee of a trust. However, the analysis and conclusions in this QWBA are equally applicable if:
 - The person disposing of the land is the trustee of a trust, and
 - The dwelling was the main home for a beneficiary of the trust; and either
 - A principal settlor of the trust does not have a main home; or
 - The dwelling was the main home of a principal settlor.

How does the bright-line test apply to a sale of the subdivided section?

7. Before considering the main home exclusion further, it is useful to consider how the bright-line test applies to the sale of a subdivided section. Section CB 6A(1) sets out the basic bright-line test for sales of residential land within the bright-line period, and s CB 6A(2) sets out a special rule that applies to sales of residential land that the seller has subdivided.
8. Essentially, under s CB 6A(2), when a person sells a section of land that they have subdivided, the bright-line period that applies is the bright-line period that would have applied to the undivided land. Therefore, the bright-line period for the subdivided section does not begin when that subdivided section is registered; rather it begins when the transfer of the undivided land to the seller was registered. The fact that separate computer registers (previously certificates of title) are created for the subdivided sections is irrelevant to the bright-line period.
9. The bright-line test applies to “residential land”, which is a broadly defined term. The broad definition means that a subdivided section of land can still be residential land even where there is no dwelling on the land. For land to be residential land, it is sufficient that it is land for which the owner has an arrangement that relates to erecting a dwelling, or that the land is bare land that may be used for erecting a dwelling under the operative district plan.
10. The definition of residential land also excludes land that is:
 - “farmland”, or
 - used predominantly as business premises.
11. If a subdivided section of land is not residential land, the sale of the section will not be subject to the bright-line test.

Can the main home exclusion apply to a sale of a subdivided section of land?

12. The main home exclusion can apply to the sale of a subdivided section of land. This is despite the subdivided section of land being recorded in a different computer register (certificate of title) from the undivided land and despite the land having no dwelling on it. This is because the land in the subdivided section may still have been used predominantly, for most of the time the person owns the land, for a dwelling that was the seller’s main home, as required by s CB 16A(1). The onus is on the seller to prove the main home exclusion applies and, therefore, that the bright-line test does not apply.
13. The following discusses the requirements of the main home exclusion generally before discussing how these requirements can be satisfied by a subdivided section of land.

The main home exclusion

14. The main home exclusion in s CB 16A(1) provides:

CB 16A Main home exclusion for disposal within 5 years

Main home exclusion

- (1) Section CB 6A does not apply to a person who disposes of residential land, if the land has been **used predominantly, for most of the time the person owns the land, for a dwelling that was the main home** for—
 - (a) the person; or
 - (b) a beneficiary of a trust, if the person is a trustee of the trust and—
 - (i) a principal settlor of the trust does not have a main home; or
 - (ii) if a principal settlor of the trust does have a main home, it is that main home which the person is disposing of.

[Emphasis added]

15. For the main home exclusion to apply, the land in question must have been used predominantly, for most of the time the seller owned it, for a dwelling that was the seller’s main home. This test has a number of elements, which are discussed below.
16. The land in the subdivided section must have been used predominantly for a dwelling that was the seller’s **main home** for more than 50% of the seller’s period of ownership. “Main home” is defined in s YA 1:

main home means, for a person, the 1 dwelling—

 - (a) that is mainly used as a residence by the person (a home); and
 - (b) with which the person has the greatest connection, if they have more than 1 home

17. There are three points to note from the “main home” definition:
 - A person can only have one “main home” under this definition.
 - To be the “main home” of a person, a dwelling must be mainly used as a residence by the person (ie, a home).
 - If the person has more than one home, the main home is the home with which the person has the greatest connection.
18. The Commissioner’s guidance on the “permanent place of abode” test can assist in determining which property the seller has the greatest connection with. That guidance is in “IS 16/03: Tax residence” *Tax Information Bulletin* Vol 28, No 10 (October 2016): 2.
19. Land that is “**used... for a dwelling**” is not limited to the land on which the dwelling is situated or to the surrounding curtilage (like a yard and garden). Land used for a dwelling can also include other areas the seller uses frequently, repeatedly or customarily in connection with or for the benefit of the dwelling. In the Commissioner’s view, for an area of land to be “used for a dwelling” the land must be actually used for the dwelling. It is the **actual use** of the land, **rather than any intended use**, that is relevant.
20. The extent to which residential land is used **in connection with or for the benefit of a dwelling** is a question of fact that turns on the circumstances of each case. Factors that may indicate land is being used for a dwelling include whether the land is:
 - set aside exclusively for private residential purposes;
 - being used for an activity that complements or adds to the enjoyment of the dwelling;
 - clearly identifiable as being used in connection with or for the benefit of the dwelling; and
 - incidental to the enjoyment of the dwelling.
21. The area of land in question must have been used for a dwelling **by the seller**.
22. For the main home exclusion to apply, the land in the subdivided section needs to have been **used predominantly** for a dwelling that was the seller’s main home. This is a physical area test. The test involves a comparison of the physical area of land used by the seller for the dwelling and the total area. “Predominantly” in this context means more than 50%.
23. From time to time, particularly where the split between the seller’s private residential use of the land in the subdivided section and their use of the land in the subdivided section for other purposes is close, the nature and the importance of the different uses could be taken into account to determine the seller’s predominant use. The Commissioner considers this is the best interpretation of the exclusion because it is consistent with the scheme of the land rules and the purpose of the provision. It also takes into account case law on the interpretation of words like “predominantly” in the context of the land rules.
24. The words “for **most of the time** the person owns the land” require a comparison between the length of time the land was predominantly used for a dwelling by the seller and the length of time the seller owned the land. “Most” means more than 50%.

The main home exclusion can apply to a subdivided section of land

25. The main home exclusion can apply to a subdivided section of land. There is no need for there to be a dwelling on the subdivided section. Land in a subdivided section without a dwelling can satisfy the requirement of being used predominantly, for most of the time the seller owned it, for a dwelling that was the seller’s main home.
26. Section CB 23B clarifies that the land taxing provisions and the exclusions apply to an amount derived from the disposal of land where that land is part of the land to which the relevant section applies, the whole of the land to which the relevant section applies or disposed of together with other land to which the relevant section applies. The Commissioner considers that s CB 23B does not affect the conclusion that the main home exclusion can apply to a subdivided section of land and that there is no need for there to be a dwelling on the subdivided section.
27. The Commissioner considers the seller of a subdivided section of land owns the land in the subdivided section from the date they acquired the undivided land. The fact that new computer registers (certificates of title) are created on subdivision does not mean that the seller did not already own the land in the subdivided section. The seller had an interest in the land in the subdivided section while it was part of the estate of the undivided land.
28. The land in the subdivided section could satisfy the requirements of the main home exclusion based solely on the use of the land in the subdivided section prior to the subdivision. The use of the land in the subdivided section after subdivision could also be relevant if, before being sold, the land continues to be used for a dwelling on one of the other sections resulting from the subdivision.

Example 1 – sale of subdivided section of land with no new dwelling

Simon acquires a property as his main home and, due to a change of circumstances, decides to subdivide it after 2 months. New computer registers (certificates of title) are created for the subdivided section with the dwelling and the subdivided section at the rear of the property that was used as the backyard for Simon's home (the backyard section). While attempting to sell the backyard section, Simon continues to enjoy the land in the section as his backyard. Simon eventually manages to sell the section 12 months later.

The sale of the backyard section is within the bright-line period that would have applied for the undivided property. Simon can use the main home exclusion for the sale because the land in the backyard section was predominantly used in connection with a dwelling that was Simon's main home for most of (in fact, all of) the time he owned the land.

Some activities undertaken on land in a subdivided section, before or after subdivision, may mean that the land is not being used for a dwelling that was the seller's main home. The period of ownership while that activity was being undertaken will need to be taken into account when calculating whether the seller has used the land in the subdivided section for a dwelling that was their main home for most of the time it was owned.

Example 2 – sale of subdivided section of land with new dwelling

Same facts as in Example 1 except that immediately after subdividing the backyard section Simon clears the area and begins constructing a new dwelling with surrounding curtilage (a small garden and a garage).

The main home exclusion will not apply to the sale of the backyard section of land because the land in the section was not used predominantly for a dwelling that was Simon's main home for most of the time he owned the land. Simon owned the land for a period of 14 months, but only used the land in the subdivided section for his main home for 2 months.

Example 3 – Delay in using the land as the main home

Hugo purchases empty land with the intention of building his dream home on it. It takes 18 months to obtain finalised architectural plans, the relevant building consents and engage a builder. Construction and final sign off take a further 18 months to complete. While the house is under construction Hugo lives with family in a nearby suburb. Hugo finally moves into the house 3 years after purchasing the land.

The cost of construction was more than Hugo had anticipated and he decides to subdivide and sell off a portion of his backyard to help pay his mortgage.

It takes a further year after moving into the house for Hugo to subdivide and sell the portion of his backyard. At all times during this period the subdivided portion of the backyard remained part of the backyard and Hugo continued to use it. Even though the subdivided portion of Hugo's backyard was used predominantly for his dwelling (as the backyard), the sale of the subdivided portion of the backyard is not excluded from the bright-line test by the main home exclusion. Hugo has owned the land for 4 years, but only lived in the house for 1 of the 4 years (25% of the time he owned the land). Hugo has not used the subdivided portion of the backyard for a dwelling that was his main home for more than 50% of the time that he has owned the land.

How many times can a seller use the main home exclusion?

29. Under s CB 16A(2) the main home exclusion will not be available where a seller disposes of residential land and:
 - the seller has already used the main home exclusion two or more times within the 2 years immediately preceding the bright-line date (eg, in the case of a sale of land, within 2 years of the date the sale agreement is entered into); or
 - the seller has engaged in a regular pattern of acquiring and disposing of residential land.
30. Each section of land that results from a subdivision is a separate piece of residential land. If the main home exclusion is applied to the sale of multiple sections of land resulting from a subdivision (which could include the section with the dwelling), the application of the exclusion to each section will count as a separate use of the exclusion for the purposes of s CB 16A(2)(a).
31. This means, for example, if an area of residential land was subdivided into three sections of land and all three sections were sold and the main home exclusion was relied on for the sale of the first two sections, the main home exclusion could not be relied on for the sale of the third section (or for any other sales made by the seller in the following 2 years).
32. Additionally, the acquisition of undivided land and subsequent sales of subdivided sections will be taken into account when determining whether the seller has engaged in a regular pattern of acquiring and disposing of residential land.

33. These exceptions to the main home exclusion are considered further in “QB 16/07: Income tax – land sale rules – main home and residential exclusions – regular pattern of acquiring and disposing, or building and disposing” *Tax Information Bulletin* Vol 28, No 9 (October 2016): 4.

References

Subject references

Bright-line test
Main home exclusion
Subdivisions

Legislative references

Income Tax Act 2007, ss CB 6A, CB 6–CB 12, CB 16A, CB 23B,
YA 1 (“own”, “main home”, “residential land”)
Taxation (Annual Rates for 2017–18, Employment and
Investment Income, and Remedial Matters) Act 2018,
s 6(2)

Other references

“IS 16/03: Tax residence” *Tax Information Bulletin* Vol 28,
No 10 (October 2016): 2.
“QB 16/07: Income tax – land sale rules – main home and
residential exclusions – regular pattern of acquiring and
disposing, or building and disposing” *Tax Information
Bulletin* Vol 28, No 9 (October 2016): 4.

QB 18/17: Income tax — bright-line test — farmland and main home exclusions — sale of lifestyle blocks

This Question We've Been Asked (QWBA) explains when lifestyle blocks sold within the bright-line period will be excluded from the bright-line test. It will be of interest to sellers seeking to rely on the farmland or main home exclusions.

Question

When is the sale of a lifestyle block sold within the bright-line period excluded from the bright-line test?

Answer

The sale is excluded when the farmland or main home exclusions apply:

1. The farmland exclusion will apply where the land is, or could in its current state, be used for a farming or agricultural business carried on by the owner. Lifestyle blocks are generally not farmland.
2. The main home exclusion will apply where:
 - More than 50% of the area of the land has been used for the seller's main home. This includes curtilage and other land used for residential purposes; and
 - The land has been used in that manner for more than 50% of the time the seller owned it.

Key Terms

Bright-line period: The bright-line period is 2 years or 5 years, depending on the rules in place when the seller acquired the land.

Bright-line test: The bright-line test applies to tax sales of residential land occurring within the bright-line period.

Curtilage: An area of land attached to a dwelling and forming one enclosure with it, such as a yard or garden.

Main home: A dwelling that is mainly used as a home by the seller and, if the seller has more than one, the home with which the seller has the greatest connection.

Explanation

The bright-line test

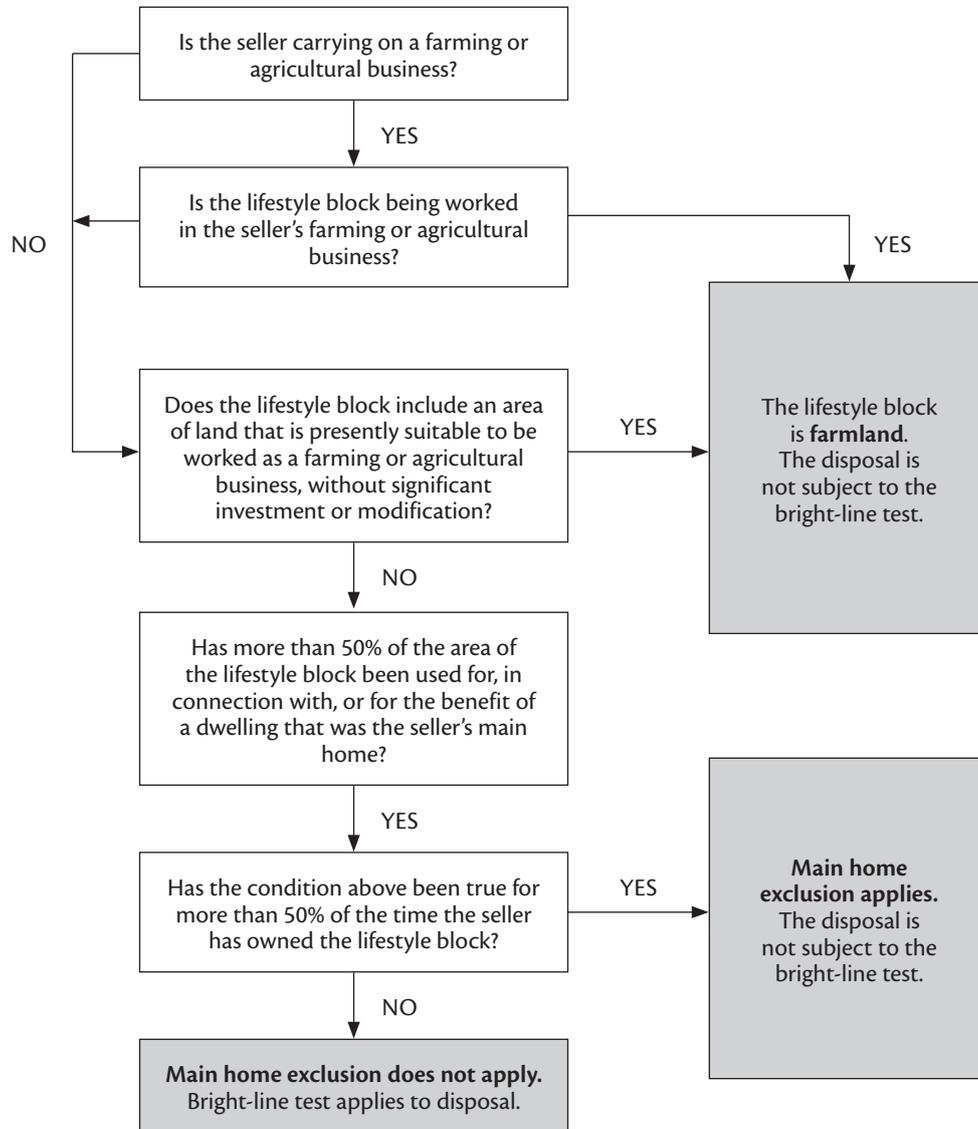
1. The bright-line test taxes residential land sold within the bright-line period.
2. The bright-line test applies to residential land that a person first acquired an interest in on or after 1 October 2015. The period of the bright-line test increased from 2 years to 5 years for residential land that a person first acquired an interest in, on or after 29 March 2018 (see s 6(2) of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018). Therefore, this QWBA refers to the "bright-line period" which will be 2 years or 5 years, depending on when the seller first acquired an interest in the land.

Scope of this QWBA

3. This QWBA is about when the sale of a lifestyle block is excluded from the bright-line test. It considers the farmland and main home exclusions as these are the most relevant exclusions in this context. The business premises exclusion is not discussed in this QWBA.
4. In this QWBA it is assumed that:
 - there was a dwelling on the land that was the seller's main home;
 - none of the other land rules in ss CB 6 to CB 12 of the Income Tax Act 2007 apply to the sale of the land (eg, s CB 6, which applies to the sale of land acquired for the purpose of re-sale). The bright-line test potentially applies only where the sale is not taxed under any of the other land rules; and
 - none of the exceptions to the main home exclusion apply (see [40]).
5. Additionally, for simplicity this QWBA assumes that the person disposing of the land is not the trustee of a trust. However, the analysis and conclusions in this QWBA are equally applicable if:
 - The person disposing of the land is the trustee of a trust, and
 - The dwelling was the main home for a beneficiary of the trust; and either
 - A principal settlor of the trust does not have a main home; or
 - The dwelling was the main home of a principal settlor.

6. The flowchart summarises the main steps when determining whether the bright-line test applies to a lifestyle block. These steps address the question of whether the land is farmland and the application of the main home exclusion. The flowchart assumes that the lifestyle block is residential land if it is not farmland, and that none of the exceptions to the main home exclusion apply.

Flowchart: Steps to determine whether the bright-line test and main home exclusion apply to a sale of a lifestyle block within the bright-line period



QUESTIONS WE'VE BEEN ASKED

Is a lifestyle block “farmland”?

7. The bright-line test applies to sales and other disposals of “residential land”. The definition of residential land relevantly excludes “farmland”. Therefore, if a lifestyle block is “farmland”, it is not subject to the bright-line test.
8. “Farmland” is defined. To be “farmland”, an area of land needs to be **land** that:
 - is being worked in the farming or agricultural business of the land’s owner; or
 - because of its area and nature, is capable of being worked as a farming or agricultural business.
9. The first limb of the “farmland” definition focuses on the actual use of the land, while the second limb focuses on the qualities of the land. The criteria in the definition of farmland are objective. The onus is on the seller to prove the land is farmland and, therefore, that the bright-line test does not apply. Because “residential land” is defined for the bright-line test only, it follows that the time for testing whether land is farmland is when the bright-line test applies; that is, at the time the land is sold.
10. Farmland can include land that has a dwelling on it. In determining if the land is farmland there is no apportionment between the area of land used for the dwelling and the area of land used for farmland. Land is either farmland or not farmland. Therefore, if a lifestyle block is farmland, it is not subject to the bright-line test because it is not residential land.

When is a lifestyle block being worked in the farming or agricultural business of the seller?

11. Under the first limb of the definition, a lifestyle block will be farmland if it is being worked in the farming or agricultural business of the seller. This requires the seller to be able to show that:
 - they are carrying on a farming or agricultural business, and
 - the lifestyle block is being worked in that business.
12. The Commissioner considers that in the context of the bright-line test and the definitions of residential land and farmland, a farming or agricultural activity is being carried on when a lifestyle block is being used for:
 - cultivating and growing crops, including horticulture and viticulture,
 - breeding or rearing livestock, including poultry and bee keeping, or
 - forestry.
13. In addition, the farming or agricultural activity must be carried on as a business.
14. The leading case on the meaning of “business” is *Grieve v CIR* (1984) 6 NZTC 61,682 (CA). *Grieve* concerned a farming activity that, ultimately, did not generate profits. Richardson J interpreted “business” as meaning an activity carried on in an organised and coherent way with an intention to make a profit. A person’s intention to make a profit will be evidenced by their conduct. Factors that are relevant for determining if a person is carrying on a business include:
 - the nature of the activity being engaged in;
 - the period over which the activity is engaged in;
 - the scale of operations;
 - the volume of transactions;
 - the commitment of time, money and effort;
 - the pattern of activity; and
 - the financial results.
15. Whether a lifestyle block is being worked in the farming or agricultural business of the seller is a question of fact. Many owners of lifestyle blocks will keep animals or grow crops or trees on their land, but if the livestock or produce of the activity is not sold (or not intended to be sold), then there will be no business activity. Even if the livestock or produce is sold, the owner may not be able to demonstrate that they are carrying on that activity in an organised and coherent way with the intention to profit from the activity, as is required for the activity to be a business. For many lifestyle block properties, the size and nature of the property will limit the scale of operations that can be carried on, which will make it difficult to satisfy the business test.
16. The first limb of the “farmland” definition requires that the land is “being worked in the farming or agricultural business of **the land’s owner**”. This means the seller of the lifestyle block must be engaged in a farming or agricultural business and the land must be “being worked” in that business. The business requirement can be satisfied if the lifestyle block is being worked, in conjunction with other land that is owned or leased by the seller, in their business. However, this requirement would not be satisfied where the land is merely being rented to someone else who carries on a farming or agricultural business.

When is a lifestyle block, because of its area and nature, capable of being worked as a farming or agricultural business?

17. The second limb of the “farmland” definition includes land that, “because of its area and nature”, is capable of being worked as a farming or agricultural business. This requires consideration of both the area and the nature of the land together to determine if the land is capable of being worked as a farming or agricultural business.
18. Whether a lifestyle block is an **area** capable of being worked as a farming or agricultural business depends on the proposed activity the seller considers it capable for. The seller needs to evaluate whether the area of the lifestyle block is sufficient to enable it to be worked as a farming or agricultural business when considering the proposed activity. The larger the area of the lifestyle block, then potentially the larger the scale of any farming or agricultural activity and the greater the likelihood that the proposed activity will constitute a business. It would be difficult for the seller to show a lifestyle block is capable of being worked as a farming or agricultural business if the area of the block means it would not be capable of producing a profit when used for the proposed activity. In establishing whether the land being sold has an area and nature capable of being worked in a farming or agricultural business it needs to be considered in isolation from other parcels of land.
19. The Commissioner considers, based on *CIR v Bruhns* (1989) 11 NZTC 6,075 (CA), that the words “is capable of being” in para (b) focus on the existing or present nature of the lifestyle block at the date of sale, rather than any unrealised potential in the lifestyle block. This means a lifestyle block that requires significant investment or modification to be used in the proposed activity does not have the **nature** to make it capable of being worked as a farming or agricultural business, and the lifestyle block would not qualify as farmland.
20. The onus is on the seller to prove that the lifestyle block at the date of sale has an area and nature presently capable of being worked as a farming or agricultural business and is, therefore, farmland not subject to the bright-line test. In practice, the seller would need to have a particular farming or agricultural business that they argue the lifestyle block is capable of being used for. They would also have to show that any investment or modification needed to carry on that activity is not significant. This will be a question of fact.
21. There may be situations where the owner of land that is farmland lives in the farm house and leases the majority of the land to someone else to farm. In such cases, all of the land, including the farm house, will be generally regarded as farmland and the sale of the land will not be taxed under the bright-line test.

Is a lifestyle block “residential land”?

22. The definition of residential land includes:
 - land that has a dwelling on it;
 - land for which the owner has an arrangement that relates to erecting a dwelling; or
 - bare land that is allowed to have a dwelling on it under the relevant operative district plan.
23. And, as noted above, the definition of residential land relevantly excludes farmland.

Can the main home exclusion apply to a lifestyle block?

24. The main home exclusion can apply to a lifestyle block. The main home exclusion will apply if the lifestyle block has been used predominantly, for most of the time the seller owns it, for a dwelling that was the seller’s main home. The onus is on the seller to prove the main home exclusion applies and, therefore, that the bright-line test does not apply.
25. The main home exclusion in s CB 16A(1) provides:

CB 16A Main home exclusion for disposal within 5 years

Main home exclusion

- (1) Section CB 6A does not apply to a person who disposes of residential land, if the land has been **used predominantly, for most of the time the person owns the land, for a dwelling that was the main home** for—
 - (a) the person; or
 - (b) a beneficiary of a trust, if the person is a trustee of the trust and—
 - (i) a principal settlor of the trust does not have a main home; or
 - (ii) if a principal settlor of the trust does have a main home, it is that main home which the person is disposing of.

[Emphasis added]

26. The main home exclusion has a number of elements, which are discussed below.
27. The land in the lifestyle block must have been used predominantly for a dwelling that was the seller's **main home** for more than 50% of the seller's period of ownership. "Main home" is defined in s YA 1.
28. There are three points to note about the "main home" definition:
 - A person can only have one "main home" under this definition.
 - To be the "main home" of a person, a dwelling must be mainly used as a residence by the person (ie, a home).
 - If the person has more than one home, the main home is the home with which the person has the greatest connection.
29. The Commissioner's guidance on the "permanent place of abode" test can assist in determining which property the seller has the greatest connection with. That guidance is in "IS 16/03: Tax residence" *Tax Information Bulletin* Vol 28, No 10 (October 2016): 2.
30. Land that is "**used... for a dwelling**" is not limited to the land on which the dwelling is situated or to the surrounding curtilage (like a yard and garden). Land used for a dwelling can also include other areas the seller uses frequently, repeatedly or customarily in connection with or for the benefit of the dwelling. In the Commissioner's view, for an area of land to be "used for a dwelling" the land must be actually used for the dwelling. It is the **actual use** of the land, **rather than any intended use**, that is relevant.
31. The extent to which residential land is used **in connection with or for the benefit of a dwelling** is a question of fact that turns on the circumstances of each case. Factors that may indicate land is being used for a dwelling include whether the land is:
 - set aside exclusively for private residential purposes,
 - being used for an activity that complements or adds to the enjoyment of the dwelling,
 - clearly identifiable as being used in connection with or for the benefit of the dwelling, and
 - incidental to the enjoyment of the dwelling.
32. In the case of a **lifestyle block**, **examples** of land that is used for a dwelling (other than the house and curtilage) are:
 - areas set aside for growing food for domestic use,
 - areas for pet animals, and
 - areas used to enhance the enjoyment or aesthetic value of the dwelling (eg, in the context of an average-sized (4 ha) lifestyle block, a reasonable amount of park land or covenanted native bush that is used to provide a green vista, retaining or shelter would be an area that enhances the enjoyment of a dwelling).
33. Another example of land used for a dwelling is land used for hobby farming on a lifestyle block. For the purposes of this QWBA, hobby farming refers to a farming or agricultural activity undertaken by the seller on land that does **not** meet the definition of "farmland" (eg, because the area of the land used for the activity is too small to sustain a farming or agricultural business).
34. For the main home exclusion to apply, the land in the lifestyle block needs to have been **used predominantly** for a dwelling that was the seller's main home. This is a question of fact and the test is a physical area test. The test involves a comparison of the physical area of land used for the dwelling and the total area. "Predominantly" in this context means more than 50%.
35. The leasing or licencing of part of the lifestyle block to another person will not necessarily mean that that part is not used for the dwelling, as long as the other person's use of the land is complementary to the seller's enjoyment of the property (eg, where a neighbour has grazed some animals on the seller's land to keep the grass down) and the seller continues to use the land as a matter of fact.
36. However, in some cases, the leasing or licencing of part of the lifestyle block may mean that the seller is effectively excluded from using that part of the land as a matter of fact.
37. The Commissioner considers that it will typically be difficult for the seller to show that part of the seller's lifestyle block that is leased to someone else with exclusive possession is used for the seller's dwelling. If the area of land not used for the seller's dwelling exceeds 50% of the total area of the land the sale will be subject to the bright-line test.
38. From time to time, particularly where the split between the seller's private residential use of the land in the lifestyle block and their use of the land in the lifestyle block for other purposes is close, the nature and the importance of the different uses could be taken into account to determine the seller's predominant use. The Commissioner considers this is the best interpretation of the exclusion because it is consistent with the scheme of the land rules and the purpose of the provision. It also takes into account case law on the interpretation of words like "predominantly" in the context of the land rules.

39. The words “**for most of the time** the person owns the land” require a comparison between the length of time the land was predominantly used for a dwelling by the seller and the length of time the seller owned the land. “Most” means more than 50%.

Exceptions to the main home exclusion

40. There are two exceptions that may prevent the main home exclusion applying (see s CB 16A(2)).
41. These exceptions are considered in “QB 16/07: Income tax – land sale rules – main home and residential exclusions – regular pattern of acquiring and disposing, or building and disposing” *Tax Information Bulletin* Vol 28, No 9 (October 2016): 4. Briefly, the exceptions are where:
- The seller has already used the main home exclusion two or more times within the two years immediately preceding the bright-line date (eg, in the case of a sale of land, within 2 years of the date the sale agreement is entered into).
 - The seller has engaged in a regular pattern of acquiring and disposing of residential property that was their main home.

Examples

The following examples assume that the property has been used as the seller’s main home for all the time they owned the property and that the exceptions to the main home exclusion do not apply.

Example 1: Land that because of its area cannot be used as farmland

Marama had a 1 hectare property that she sold within the brightline period. The property had a house that she used as her main home. The property also had a small area of grazing land and a larger area of native bush. She kept a few sheep on the grazing land to keep the grass down.

The property was not farmland because it wasn’t being worked in a farming or agricultural business carried on by Marama. Nor, given the size of the property, could Marama argue it was capable of being worked as a farming or agricultural business. The property was a hobby farm, not farmland.

The main home exclusion is available to Marama because more than 50% of the area of the property was used for her dwelling. The grazing land was an area for her hobby-farming activity, and the area of native bush was used to enhance her enjoyment and the aesthetic value of her dwelling. Therefore, the sale of Marama’s property within the bright-line period will not be taxed under the bright-line test.

Example 2: Plot of land that is farmland

Uri had a 5 hectare property that he used for a commercial rose growing business. A small area of the land is used for his house and the garden around it.

The property is farmland because it was being worked in Uri’s agricultural business. The sale of Uri’s property (including the house) within the bright-line period will not be taxed under the bright-line test because the land is not residential land.

Example 3: Part of property leased to an avocado grower

Tom and Jess had a 2 hectare property that they sold within the brightline period. The land included 1.5 hectares of avocado trees with shelter belts. The balance of the land was used for a house that Tom and Jess used as their main home as well as a flower garden, a vegetable garden and a paddock for grazing Jess's two horses. The avocado trees were leased to an avocado-growing company that looked after the trees including spraying the trees, mowing between the rows of trees and picking the fruit. The lease gives exclusive possession to the avocado-growing company and Tom and Jess do not go into the avocado orchard.

The property was not farmland because:

- It was not being worked in an agricultural business carried on by Tom and Jess (rather, it was being worked in the avocado-growing company's agricultural business); and
- In this case, the 1.5 hectares of avocado trees was not of sufficient scale to be capable of being carried on as an avocado-growing business given the number of avocado trees on the land.

The main home exclusion is not available to Tom and Jess because less than 50% of the area of the property is used for their dwelling. The dwelling, its flower garden, the vegetable garden and the land for grazing the horses are all physically used for purposes in connection with the enjoyment of the dwelling, rather than for any other purposes. However, most of the land (75%) was leased to the avocado-growing company and was not used for Tom and Jess's dwelling. Therefore, the sale by Tom and Jess of the property within the bright-line period will be taxed under the bright-line test.

References**Subject references**

Bright-line test

Main home exclusion

Legislative references

Income Tax Act 2007, ss CB 6A, CB 6–CB 12, CB 16A, YA 1 (“business”, “farmland”, “main home” and “residential land”)

Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018, s 6(2)

Case references

CIR v Bruhns (1989) 11 NZTC 6,075 (CA)

Grieve v CIR (1984) 6 NZTC 61,682 (CA)

Other references

“IS 16/03: Tax residence”, *Tax Information Bulletin* Vol 28, No 10 (October 2016): 2

“QB 16/07: Income tax – land sale rules – main home and residential exclusions – regular pattern of acquiring and disposing, or building and disposing” *Tax Information Bulletin* Vol 28, No 9 (October 2016): 4

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.

Amount of honoraria paid to Royal New Zealand Plunket Trust volunteers that shall be regarded as expenditure incurred in production of that payment

Application

All references to legislation are to the Income Tax Act 2007.

This determination is made under section RD 8(3) and shall apply to honoraria paid to the Royal New Zealand Plunket Trust ("Plunket") volunteers who undertake voluntary activities for Plunket.

This determination may be cited as "*Determination 18/02: Determination of expenditure incurred for honoraria payments made by the Royal New Zealand Plunket Trust*".

This determination shall apply for the period 1 January 2018 to 31 March 2019.

For the purposes of section CW 62B, "volunteer" means a person who freely undertakes an activity in New Zealand:

- a) Chosen either by themselves or by a group of which they are a member; and
- b) That provides a benefit to a community or another person; and
- c) For which there is no purpose or intention of private pecuniary profit for the person.

Scope of Determination

Honoraria paid to Plunket members come within the definition of "schedular payment" under section RD 8. Schedule 4, Part B requires PAYE to be deducted from honoraria at the rate of 33%.

Under section RD 3(1) a schedular payment is included in the definition of "PAYE income payment". Consequently, any person who makes a schedular payment must deduct tax from it at the time it is made, unless an exemption applies.

Section CW 62B provides that an amount that is a reimbursement payment to cover expenses incurred by a volunteer when undertaking a voluntary activity, is exempt from income tax.

Section RD 8(3) allows the Commissioner to determine an amount or proportion of any schedular payment that is considered to be expenditure incurred that is exempt from income tax. If the Commissioner has made such a determination, the person making the schedular payment is only required to deduct tax from the amount that exceeds the determined expenditure amount.

Determination

When any Plunket volunteer receives honoraria as reimbursement of expenditure that person had incurred in carrying out Plunket related activities, that payment up to a maximum of \$800 per tax year, shall be regarded as expenditure incurred in the production of that payment. However, if the volunteer receives any reimbursement (in addition to honoraria) for expenditure they have incurred, the amount exempted under this determination (\$800) shall be reduced by that additional reimbursement.

Rob Wells

Manager, Technical Standards, OCTC

28 September 2018

Example 1

A Plunket volunteer receives honoraria of \$500 in respect of the Plunket related activities carried out during the tax year. No other reimbursement had been paid during the year. The payer does not have to deduct withholding tax because the total payment does not exceed \$800.

Example 2

A Plunket volunteer receives a payment of \$625 at the end of February. During the tax year, in the preceding May, August and November the volunteer had also received three smaller payment of \$100 each as reimbursement of travel expenses incurred for Plunket related activities, making a total of \$925 for the year. Because the Plunket volunteer had received reimbursement payments of \$300 earlier in the year, only \$500 of the honorarium received in February could be regarded as expenditure incurred under this determination. Therefore, tax of \$41.25 should be deducted from the balance (\$125) of the honorarium.

LEGAL DECISIONS – CASE NOTES

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

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

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

Court of Appeal holds that expenditure incurred in deriving dividends is deductible pursuant to s DB 55 of the Income Tax Act 2007

Case	<i>NRS Media Holdings Ltd v Commissioner of Inland Revenue</i> [2018] NZCA 472
Decision date	1 November 2018
Act(s)	Income Tax Act 2007, s DA 1, DA 2 and DB 55
Keywords	Expenditure, Nexus, Dividends, Capital limitation and General Permission

Summary

In its tax returns for the 2011 and 2012 income years, NRS Media Holdings Ltd (“NRS”) claimed deductions for expenditure incurred in deriving exempt foreign dividends. The Commissioner of Inland Revenue (“the Commissioner”) disallowed those deductions on the basis that the expenditure did not have the necessary nexus with the dividends.

NRS commenced challenge proceedings in the High Court; Clark J upholding the Commissioner’s determination (*NRS Media Holdings Ltd v Commissioner of Inland Revenue* [2017] NZHC 2978, (2017) 28 NZTC 23-048). NRS appealed and the Court of Appeal held that the expenses for which NRS claimed deductions represent recurrent and regular business expenses, which are all manifestly revenue expenses. The Court of Appeal accordingly held that NRS ought to be entitled to a deduction for these expenses.

Impact

This case illustrates that there is little support in the authorities that for expenditure to be deductible under s DB 55 of the Income Tax Act (“the ITA”), a taxpayer has to show a direct link between the expenditure incurred and the derivation of dividends. The authorities also do not suggest that there is any great distinction between the tests for nexus under either subs 1(a) or 1(b) of s DA 1. What is required is the application of the statutory language to the particular circumstances.

Facts

NRS was the sole or majority shareholder of several subsidiaries (the subsidiaries). Two were incorporated in the United Kingdom, one was incorporated in Australia and another was incorporated in Canada. Those subsidiaries derived income by facilitating the purchase of media time by their client advertisers. Central to that business was software developed and licensed to them by a sister company of NRS, Persuaders Concepts (NZ) Ltd (Persuaders). For its part as parent company, NRS set the strategic plan for its group as a whole, and for each of its subsidiaries. In turn, it approved and monitored the business plans and the business activities of its subsidiaries as they operated within those strategic plans. It was in undertaking those activities that NRS incurred the expenses in question.

NRS categorised those expenses as comprising “payroll and consultants”, “marketing and travel”, “rent and occupancy” and “overheads”. These expenses totalled \$1,706,568.23 and \$1,963,472.31 in the 2011 and 2012 income years respectively.

NRS described the overall objective of its activities as being:

1. to maximise the financial return to the shareholders of NRS through increased dividends from the NRS subsidiaries, for the benefit of NRS; and
2. to enable NRS and its Board to discharge their obligations as parent company, from a legal governance perspective.

The NRS subsidiaries were self-sufficient, with their own accounting, sales and management teams, and did not require support or services to be provided by NRS to operate on a day-to-day basis.

Decision

Nexus required under s DB 55 of the ITA

After having considered *Commissioner of Inland Revenue v Banks* [1978] 2 NZLR 472 (CA), as well as *Buckley & Young Ltd v Commissioner of Inland Revenue* [1978] 2 NZLR 485 (CA), the Court of Appeal noted Richardson J spoke in the alternative of “the gaining or producing of his assessable income” and “with the carrying on of a business for that purpose” without distinction as regards nexus. In light of this, it concluded that Richardson J appeared to see no reason to distinguish between the approach called for on that issue as regards the two provisions.

The Court of Appeal also held that there was little, if any, support that for the claimed expenditure to be deductible under s DB 55 of the ITA, NRS needed to show that the expenditure was:

1. directly linked to its exempt foreign dividend income in a positive way;
2. factually and casually directed to the production of the dividend income; and
3. incurred in the course of producing the dividend income.

The authorities do not seem to suggest a distinction between the tests for nexus under either of subs 1(a) or 1(b) of s DA 1. Rather, what is required is the application of the statutory language – here “the amount of expenditure incurred by the company in deriving the dividend” – to the particular circumstances.

The Court of Appeal also held that the case of *Europa Oil (NZ) Ltd v Commissioner of Inland Revenue* [1974] 2 NZLR 737 (CA), did not support the nexus characterisation adopted by the Commissioner and the High Court, and that *Thornton Estates Ltd v Commissioner of Inland Revenue* (1995) 17 NZTC 12,230 (HC), did not add much to that analysis. The legislative history also did not support the Commissioner’s interpretation of s DB 55.

As to whether the nexus between NRS’ expenditure and the deriving of dividend income has the necessary characteristics to support deductibility, the Court of Appeal noted that NRS’ business was, as its witnesses described, to promote the interests of its shareholder investors by maximising the value of their investment and that there could be little doubt that the activities NRS engaged in for that overall purpose bore the necessary nexus with the deriving of the dividends paid to it by its subsidiaries.

After having considered Mr Gold’s evidence, director of NRS, the Court of Appeal held that the necessary nexus did exist between the claimed expenditure and the exempt dividend income derived.

Whether NRS’ expenditure was of a capital nature pursuant to s DA 2 of the ITA?

The Court of Appeal noted that the approach for determining whether expenditure is of a capital nature is settled, as demonstrated by the Court’s decision in *Easy Park Ltd v Commissioner of Inland Revenue* [2018] NZCA 296, (2018) 28 NZTC 23-066. Ultimately the focus must be on what the expenditure was calculated to effect from a practical and business point of view.

The Court of Appeal held that NRS’ business operations were, fundamentally, the oversight of its subsidiaries. The real value in the media business operated by NRS and NRS’ subsidiaries was in the intellectual property of their business systems. From a practical and business point of view, NRS’ expenditure was calculated to simply facilitate the operations of the subsidiaries rather than to improve the capital of the subsidiaries. In this respect, the Court of Appeal held that the expenses for which NRS claimed deductions represent recurrent and regular business expenses that NRS was entitled to deduct.

Application to appeal decisions relating to proceedings that have been struck out

Case	<i>Garry Albert Muir v Commissioner of Inland Revenue</i> [2018] NZCA 456
Decision date	26 October 2018
Act(s)	High Court Rules 2016, r 15.1, Tax Administration Act 1994, s 138D
Keywords	Strike out, dismissal, leave to appeal, amended pleadings

Summary

The appellant, Garry Albert Muir (“Dr Muir”) brought separate appeals in relation to two High Court decisions. The first High Court decision (per Toogood J), *Muir v Commissioner of Inland Revenue* [2017] NZHC 2082, (2017) 28 NZTC 23-029, concerned the Commissioner of Inland Revenue’s (“the Commissioner”) challenge of the High Court registrar’s acceptance of Dr Muir’s amended statement of claim for the 1997 and 2007 to 2010 tax years.

The second decision (per Jagose J), *Muir v Taxation Review Authority* [2017] NZHC 2932, concerned Dr Muir’s judicial review application of the Taxation Review Authority’s (“TRA”) refusal to accept for filing an amended notice of claim for the 1998 to 2006 tax years. In both cases, the High Court found for the Commissioner.

In this proceeding, before the Court of Appeal, Dr Muir appealed both High Court decisions on the basis that in his view he was entitled to replead his challenge proceedings as they involved facts the courts had not previously considered. Ultimately, the Court of Appeal found for the Commissioner, awarding her costs and dismissed both of Dr Muir’s appeals.

Impact

Where a court has substantively struck out proceedings, those proceeding have ended and cannot be repleaded by filing amended pleadings.

Facts

These proceedings relate to Dr Muir’s personal liability for income tax resulting from the Supreme Court’s decision in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289, which found the Trinity scheme void against the Commissioner. Dr Muir subsequently challenged the Commissioner’s assessments.

On 1 February 2011, the TRA struck out Dr Muir’s challenges to the Commissioner’s assessments for the tax year 1998 – 2006. Dr Muir appealed this decision to the High Court. On 22 April 2015, Faire J of the High Court dismissed this appeal and in the same proceeding struck out challenges Dr Muir had also raised in relation to the tax years 1997 and 2007 – 2010.

Dr Muir appealed Faire J’s decision to the Court of Appeal and on 8 December 2015 the Court of Appeal upheld Faire J’s decision and dismissed the appeal (*Muir v Commissioner of Inland Revenue* [2015] NZCA 591, (2015) NZTC 22-034). Dr Muir sought leave to appeal the Court of Appeal’s decision and the Supreme Court refused leave in respect of the 1997 and 1998 years but did grant leave to appeal in relation to the 1999- 2000 years. That leave was later revoked when Dr Muir changed his grounds of appeal. This had the effect of the Court of Appeal decision standing and Dr Muir’s tax challenges remaining struck out.

Nevertheless, Dr Muir attempted to file an amended notices and statements of claim in the TRA and High Court. The TRA refused to accept filing, which Dr Muir judicially reviewed and lost (Jagose J decision). The High Court accepted filing, which the Commissioner challenged and won (Toogood J decision). These decisions were the subject of this Court of Appeal decision.

Separate to these proceedings, Associate Judge Bell entered summary judgment in favour of the Commissioner against Dr Muir for unpaid taxes, interest and penalties for the 1997 to 2010 tax years. Dr Muir lost his appeal of that decision to the Court of Appeal and was declined leave by the Supreme Court on the basis that Associate Judge Bell’s decision created a res judicata given Dr Muir’s tax challenges had been finally determined.

Decision

The Court of Appeal dismissed Dr Muir’s appeals and awarded costs to the Commissioner.

Prior to the Supreme Court’s decision in refusing Dr Muir leave to challenge Associate Judge Bell’s summary judgment decision, the Court of Appeal had concluded that given the challenge proceedings were at an end they would have dismissed these appeals in any event. However, the Court of Appeal considered the Supreme Court’s decision noting that Associate Judge Bell’s decision had created a res judicata precluding Dr Muir from bringing challenge proceedings on matters that had already been finally determined.

Dr Muir argued that the High Court rules demonstrated a distinction between striking out pleadings and staying or dismissing proceedings and that it is the Income Tax Act 2007 that imposes liability on a taxpayer and not the decision of the Commissioner or a hearing authority.

The Commissioner argued that the decisions of the High Court and the Court of Appeal clearly struck out Dr Muir’s challenge proceedings as an abuse of process which was subsequently confirmed by the Supreme Court.

The Court of Appeal held that the phrase “striking out the proceeding” as used by Judge Barber and Faire J “can only be understood as meaning that, having been determined to be an abuse of process, Dr Muir’s challenge proceedings were, at that point, at an end.” As the proceedings were at an end, Dr Muir could not file amended notices or statements of claim and, accordingly, the appeal was dismissed.

High Court grants third party access to Court file

Case	<i>Cullen Group Limited v The Commissioner of Inland Revenue</i> [2018] NZHC 3238
Decision date	10 December 2018
Act(s)	High Court Rules 2016, r 11.5; Senior Courts Act, s 173(1); & Senior Courts (Access to Court Documents) Rules 2017, rr 8, 11 & 12.
Keywords	Access to Court Documents

Summary

Kea Investments Ltd (“Kea”), a successful party in a recent decision of the High Court of England and Wales (*Glenn v Watson* [2018] EWHC 2016 (Ch)), is considering options for enforcement against the Valley Trust, which owned shares in Cullen Group Ltd (“CGL”). This decision relates to Kea’s application to access court documents, specifically the formal court record of judgments, orders and minutes of the court, pursuant to r 8 of the Senior Courts (Access to Court Documents) Rules 2017 (“the Rules”).

Kea also requested access to the pleadings, submissions and index to the agreed bundle of documents pursuant to r 11 of the Rules. The Commissioner of Inland Revenue (“the Commissioner”) agreed to abide the Court’s decision and CGL agreed to abide the Court’s decision with respect to r 8 but opposed access to the information requested under r 11. The Court, in noting the public interest element in favour of disclosure, granted Kea’s request under both rules.

Impact

The Court noted that while the principle of open justice is not a presumption, it is a starting point (at [21]). Access to the court record is more likely where the circumstances constitute a public purpose and where it contributes to the orderly and fair administration of justice (at [25]), such as enforcement of a judgment issued in other (overseas) proceedings.

Facts

The New Zealand proceeding is a challenge brought by CGL, associated with Mr Eric Watson, to the Commissioner’s assessment that CGL avoided tax. The substantive hearing was heard before Palmer J in August and September 2018. During that hearing, media requested access to documents on the court file, including pleadings and submissions. The parties abided the decision of the Court and Palmer J granted access. The substantive decision is yet to be delivered.

Kea obtained judgment in the High Court of England and Wales against Mr Watson for a maximum of £43,495,891.33 with compounding interest of 6.5%. (*Glenn v Watson* [2018] EWHC 2016 (Ch)). There were also tracing orders, disclosure orders and an undertaking that Mr Watson would not dispose of, or deal in or diminish assets over £100,000 without notice (Consent Order of Nugee J, *Glenn v Watson* EWHC (Ch) HC-2015-1647, 14 September 2018). Mr Watson has appealed the interest rate awarded.

Kea says that Mr Watson did not make the interim payments, that his solicitor said Mr Watson was unable to pay the sums ordered as he did not have the assets to do so, and that the shareholder of CGL, and another company in Mr Watson’s structure, changed. Kea obtained freezing orders from the High Court of England and Wales restraining identified companies, including CGL, from dealing with or diminishing assets up to the value of £47,333,247 and is now considering enforcement options, including whether to appoint receivers in respect of Mr Watson’s interests in the Valley Trust, which Kea understands holds shares in CGL. CGL and Valley Trust feature in the factual matrix of the challenge proceeding before the New Zealand High Court and Kea applied to access the court file in that New Zealand proceeding.

Decision

Subject to r 8 of the Rules, the Court noted every person has the right to access the formal court record relating to a civil proceeding. Under r 4, the formal court record includes judgment, order or minute of the court, including a judge's reasons. The Court granted Kea access to the formal court record, noting the request was not opposed.

Under r 11 of the Rules, a person may request access to any document, however, the court must consider the nature of and reasons for the request taking into account the various considerations outlined at r 12. Those considerations are then balanced by r 13.

Kea's request for access was made to assist it with its enforcement of the English judgment, noting it would facilitate the orderly and fair administration of justice, a consideration under r 12(a) of the Rules.

CGL contended the pleadings contained large amounts of commercially sensitive material including, for example: details of the approved issuer levy tax amounts paid; the precise nature of CGL's finance structure; and the trust structures associated with CGL. CGL's counsel submitted the Rules were not designed to facilitate private applicants pursuing commercial purposes and that other mechanisms, such as pre-proceeding discovery, are available to Kea.

In finding for Kea, the Court noted the final decision in this (NZ) proceeding is yet to be delivered. Pursuant to r 13 of the Rules, the principle of open justice is given greater weight while the substantive hearing is on foot. A "substantive hearing" is defined by r 4 as being from the start of the hearing until the court delivers its judgment.

The Court also noted there was little specificity to CGL's claim of commercial confidentiality. Furthermore, media access to the court file had not previously been opposed and confidentiality orders were not sought in the proceeding.

The Court accepted that the purpose for which Kea seeks the information contributes to the orderly and fair administration of justice and it is not fishing for information in order to consider whether initiate private litigation. Kea's purpose is to seek to enforce a judgment of the High Court of England and Wales which has been issued and in respect of which that Court has subsequently granted freezing orders and disclosure orders. Enforcement of a foreign judgment in these circumstances is constitutes a public purpose, not just a private purpose, by contributing to the orderly and fair administration of justice.

Kea was granted access to the court file, including the pleadings, submissions and the index to the agreed bundle of documents on the condition Kea does not use any documents other than for the purposes of the English proceedings and related proceedings taken in other jurisdictions, without leave of the High Court of New Zealand.

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Office of the Chief Tax Counsel

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

Legal and Technical Services

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

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

Policy and Strategy

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

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