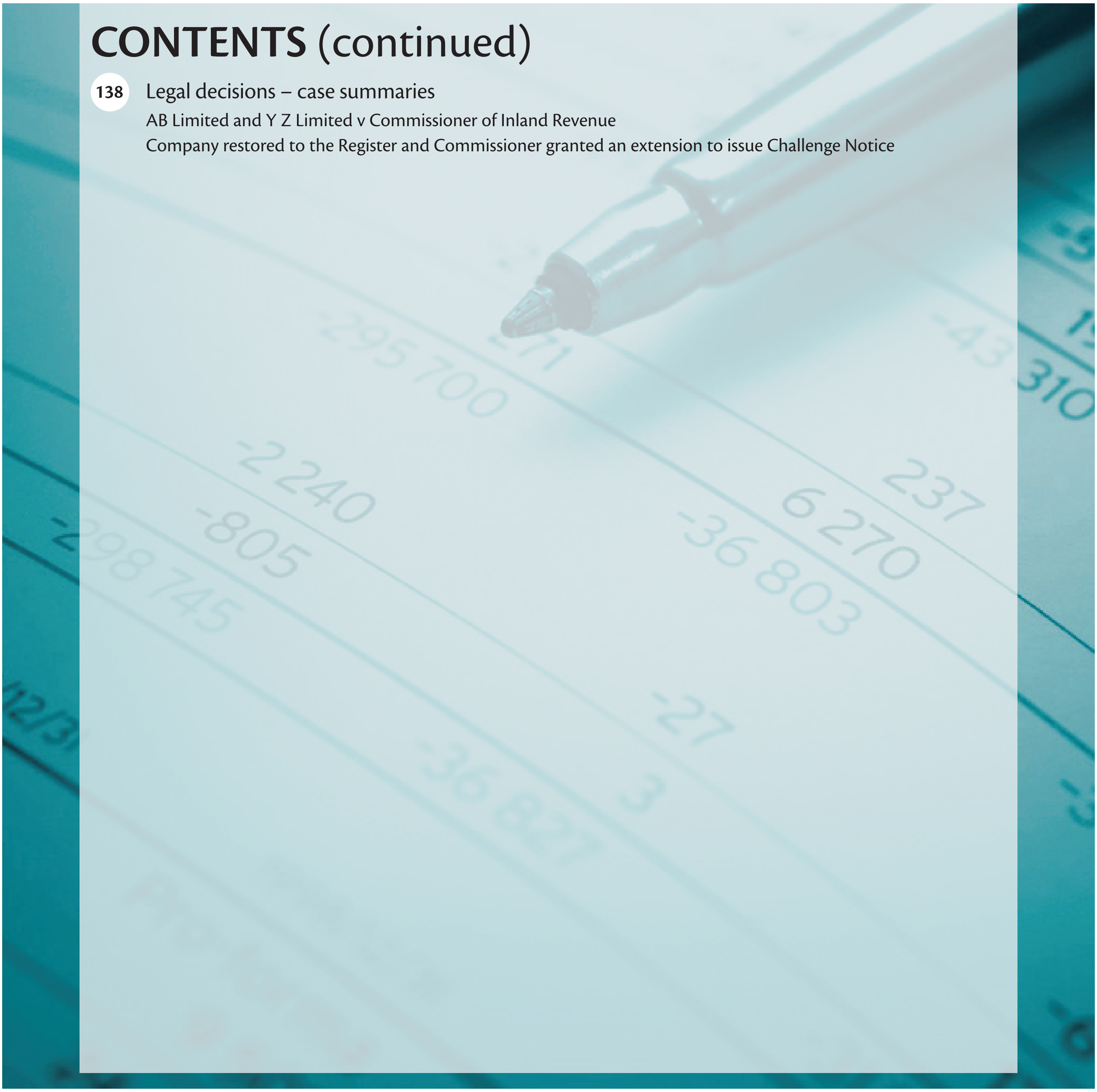
Vol 32 No 7 August 2020

TAX INFORMATION Bulletin

CONTENTS

Inland Revenue
Te Tari Taake

ISSN 1177-620X (Online)



CONTENTS (continued)

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.taxtechnical.ird.govt.nz** (search keywords: public consultation).

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

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

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

IN SUMMARY

New legislation

Legislation and determinations

IN SUMMARY (continued)

IN SUMMARY (continued)

Questions We've Been Asked

Legal decisions - case summaries – Recent Case Summaries

NEW LEGISLATION

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

COVID-19 Response (Taxation and Other Regulatory Urgent Measures) Act 2020

COVID-19 Response (Further Management Measures) Legislation Act 2020

The COVID-19 Response (Taxation and Other Regulatory Urgent Measures) Act 2020 was enacted on 30 April 2020 and the COVID-19 Response (Further Management Measures) Legislation Act 2020 was enacted on 15 May 2020. The measures in these Acts are aimed at assisting the Government's response to the economic impacts of COVID-19.

The Acts make changes to income tax, tax administration, primary industries, consumer protection and crown owned entity regulatory requirement measures

Loss carry-backs

Sections GB 3, GB 4, IC 9, ID 1, IZ 8, RC 7, RM 10, and YA 1 of the Income Tax Act 2007; sections 113G, 120KBB, and 183ABAB of the Tax Administration Act 1994

These amendments introduce a temporary tax loss carry-back measure that allows businesses that are or anticipate being in loss, to carry back some or all of that loss to the immediately preceding income year.

Background

Businesses in New Zealand pay tax on their income when they are profitable. Under existing tax loss continuity rules, losses can be carried forward to reduce taxable income in future years.

Loss carry-forwards and carry-backs are intended to prevent systematic over-taxation over time. If taxpayers always pay tax when they earn income, but never get relief when they have a loss, they will pay more than the statutory rate of tax over time. Loss carry-backs are one way to address this. The Government has also announced policy changes relating to the loss carry-forward rules, but these are not part of this Act.

The economic impacts of COVID-19 have made it more likely that taxpayers will be in loss in the 2019–20 or 2020–21 income years. Carrying a loss forward postpones the benefit of being able to claim losses and means that a taxpayer would still bear a tax liability for previous profitable years. The loss carry-back measure is intended to provide fast cash flow for businesses in loss during the period affected by COVID-19.

The measure enables tax refunds to be paid before the loss year has finished and before an income tax return has been filed for the loss year.

The measure is temporary. However the Government has indicated its intention to develop a permanent loss carry-back mechanism to apply from the 2021–22 tax year, which would replace the temporary measure.

Key features

The Act introduces a temporary measure that applies for losses incurred in the 2019–20 or 2020–21 income years. It allows for refunds of previously paid tax before the loss year is finished. Taxpayers will generally access this provision by changing their estimated provisional tax. The deadline for re-estimating provisional tax has been extended from the final instalment date until the date the tax return is due or filed, whichever is the earlier. Taxpayers are able to choose whether to use this facility.

Almost all types of taxpayers – companies, trusts and individuals – are eligible to carry back losses. The majority of individuals who are taxed through the PAYE system do not have losses so would be unaffected by this measure but those that operate businesses through partnerships, limited partnerships, and look-through companies are able to benefit.

Standard late payment use-of-money interest applies if the loss carry-back is overestimated. Ownership continuity, grouping, and imputation rules also apply.

Application date

The amendments apply from 15 April 2020.

Detailed analysis

The loss carry-back scheme involves amendments to the Income Tax Act 2007 and the Tax Administration Act 1994.

The main features of the scheme are set out in new section IZ 8 to the Income Tax Act 2007.

This section introduces the concept of the offset years – the pair of years affected by the carry-back. The first of these years is named the ***taxable income year*** and the second is named the ***net loss year***.

To be eligible to use section IZ 8, a taxpayer must have made, or estimate that they will make, a loss in 2019–20 or 2020–21 – the ***net loss year***. It must also have had taxable income in the previous year – the ***taxable income year***. Losses would only be carried back for one year. This would mean:

- losses from the 2019–20 year could be carried back to the 2018–19 year; and
- losses from the 2020–21 year could be carried back to the 2019–20 year.

Example 1

Armstrong Architects Limited (Armstrong) is a well-known architectural firm based in Christchurch and is known for its innovative designs and earthquake resistant buildings. It has been having a boom in business for the last two years but because most of its current projects are under construction its work has dropped off because of the Level 4 COVID-19 restrictions preventing work on the projects. In the 2019–20 income year it is predicting it will have taxable income of $5.6 million. However, because it has a number of high fixed costs to cover during the COVID-19 period and has no future projects in the pipeline, it anticipates that for the 2020–21 income year it will make a loss of $3.2 million.

Armstrong elects to carry back that anticipated loss to the 2019–20 income year. Armstrong has already paid $1.2 million in provisional tax over the first two provisional tax instalment dates for the 2019–20 income year and was due to pay another $368,000 on 7 May 2020. Armstrong re-estimates its provisional tax for the year to take account of the carry-back loss which will mean its taxable income will only be $2.4 million ($5.6 million – $3.2 million) with the tax liability on that being $672,000 ($2.4 million × 28%). The refund Armstrong will receive is $528,000 ($1,200,000 – $672,000) which will give it funds to assist in meeting its ongoing costs.

There are ownership continuity requirements that match those that apply to loss carry-forward provisions. These mean if a company has had an ownership change of more than 49% since the beginning of the profit year, the loss carry-back would not be available, except on a part year basis. This is to prevent the use of losses to eliminate tax on income that was not connected with the loss-making business when it was earned.

Example 2

Buzz Autos Limited (Buzz) is a car dealership specialising in American muscle cars from the 1960s. Being in a very specialised market Buzz relies on steady custom from month-to-month. With the Level 4 lockdown Buzz is struggling to stay afloat. For the 2019–20 income year Buzz estimates that it will have taxable income of $268,000 on which it has already paid $75,040 in tax. Buzz has a standard 31 March balance date.

Collins Cars Limited (Collins) is a car dealership that specialises in American muscle cars from the 1970s. It has been having a great 2019–20 year and its business model has lower fixed costs than Buzz so it has significant cash reserves.

The owner of Collins knows Buzz very well and offers to assist it get through the COVID-19 situation by purchasing 52% of Buzz, which they do on 1 May 2020.

Because of the lack of ability to trade, Buzz is anticipating that for the 2020–21 year they will have a tax loss of $341,000. However, because Buzz has not met the 49% continuity rule it will not be able to carry back that loss to the 2019–20 year. It will, however, be able to carry that portion of the loss arising after 30 April forward to the 2021–22 income year.

The part year continuity rules will allow Buzz to carry back a portion of the 2020–21 loss for the year (from 1 April 2020 to 30 April 2020), which Buzz estimates as $160,000. Buzz will need to meet the requirements to use a part year loss such as preparing part year accounts to the date of the breach in continuity.

NEW LEGISLATION

The amount that can be carried back will be the smallest of:

- the estimated loss (in 2019–20 or 2020–21), before adjusting for the carry-back;
- the taxable income in the previous year, again before adjusting for the carry-back; or
- an amount determined by the taxpayer.

Example 3

Tranquillity Limited (Tranquillity) is an online media site that publishes daily news articles and lifestyle stories with a focus on holistic lifestyles. It proved to be very popular for the year ended 31 March 2019 and made a taxable profit of $140,000.

However, Tranquillity has suffered a number of setbacks in the 2020 income year, both as a result of COVID-19 and also because of unrelated pressures facing the media industry. For the year ended 31 March 2020, Tranquillity is estimating a tax loss of $180,000.

As the limit of the loss carry-back is the lesser of the loss made in the 2020 year and the profit in the 2019 year, Tranquillity Ltd is only able to carry back $140,000 of the loss. The $40,000 excess loss balance can be carried forward to the 2021 year to offset against future profits of the company.

If the company is within a wholly owned group of companies, the amount that can be carried back is only the amount that cannot be offset against profits within its wholly owned group in the loss year. Section IZ 8(7) calculates the amount of loss that can be carried back where the taxpayer is a member of a group of companies. Essentially it requires that any loss be first offset within the wholly owned group to which the taxpayer belongs before it is able to be carried back. This will ensure the net amount of loss for the wholly owned group as a whole is carried back to a prior year.

Example 4

Apollo Supplies Group (ASG) is a 100% wholly owned group that manufactures and supplies hospitality and kitchen equipment to a range of commercial operators in New Zealand. Some companies within the group focus on manufacturing while Apollo Distribution Limited (Apollo) is responsible for sales within New Zealand.

In the year ended 31 March 2019, Apollo made a taxable profit of $420,000. It grouped its profits with the losses of other members within the ASG which, overall, made a group taxable profit of $2.5 million.

All companies within the ASG faced a downturn in revenue in the 2020 income year because of COVID-19. Apollo has been the most significantly affected company within the group and, in the year ended 31 March 2020, Apollo made a tax loss of $120,000 largely because of making virtually no sales in the last quarter of the 2020 income year. Apollo wishes to carry back its loss to the 2019 income year and offset it against other companies in the ASG.

Before Apollo carries back its loss to the 2019 year it must first make maximum use of the ability to group the loss in the 2020 year itself with its other 100% wholly owned companies in the ASG.

Together, the other members of ASG (excluding Apollo) made a taxable profit for the year ended 31 March 2020 of $90,000. As a result, the tax loss available to carry back to the 2019 year is $30,000. Apollo can group the remaining $90,000 of the 2020 loss with the profit of other group companies or carry it forward to future years.

Apollo can carry back $30,000 of its 2020 tax loss and offset this against its 2019-year profit. If it did not have sufficient profit, it could group the loss against the profits of other companies in ASG in the 2019 income year.

Section IZ 8(7) specifies the amount of a person's available tax loss where the person is a member of a group of companies. This section specifies that the amount of available net loss is the smallest of:

- The total amount of the initial taxable income and the net income of the person (for a company these amounts will be the same as a company that does not receive a rebate for donations made).
- The excess loss that remains of the total amount of net loss of the person and the other group members (after using non-refundable tax credits) if the person is a member of a wholly owned group.
- The amount elected to carry back by the person.

Example 5

The Beans group is a group of companies that sells beans in bulk to Mexican restaurants around New Zealand. Alan is the owner of the Bean Group. The temporary closure of restaurants in New Zealand because of the COVID-19 lockdown has had a big impact on the Beans Group.

The Beans group has a standard 31 March balance date and completed its 2019–20 year on 31 March 2020. Its preliminary results for the year to 31 March indicate the following taxable income for the members of the Beans Group:

Beans Beans Limited (Beans)	$ 100,000
Blazing Beans Limited (Blazing)	$(60,000)
Saddles Beans Limited (Saddles)	$ 40,000
Total	$ 80,000

It is intended that Blazing will offset its loss of $60,000 against Beans' net income. Beans' taxable income before loss carry back will be $40,000 and for the 2019–20 year the group summary will be:

Beans	$ 40,000
Blazing	$ NIL
Saddles	$ 40,000
Total	$ 80,000

In November 2020, it becomes apparent to the group that for the 2020–21 year the Beans Group is likely to have the following tax position:

Beans	$ 75,000
Blazing	$(50,000)
Saddles	$(75,000)
Total	$(50,000)

Alan would like the group to access the loss carry back available under section IZ 8.

Because Blazing and Saddles are members of a wholly owned group during the relevant years, section IZ 8(3) determines whether or not the two companies can make an election. If the expected loss of $125,000 was offset against Beans' expected income, there would be an excess loss of $50,000. So Blazing or Saddles may make the election.

Subsection IZ 8(7) sets the amount that may be elected to be carried back. For Blazing, because it has no taxable income in the 2020 year, the amount referred to in paragraph (7)(a) is the amount it can group in the 2019–20 year. Accordingly, it cannot be more than $80,000, which is the amount that could be grouped if Saddles carried back nothing. The amount referred to in paragraph IZ 8(7)(b) is whatever portion of the $50,000 excess loss in 2021 not separately carried back by Saddles.

For Saddles, the amount calculated by section IZ 8(7)(a) is $40,000 plus up to $40,000 which could be grouped with the income of Beans. Amount B is the portion of the $50,000 excess loss in 2021 that is not carried back by Blazing.

Effectively then the amount that can be carried back by the two companies in aggregate is $50,000. Suppose this is all carried back by Saddles. That means Saddles taxable income in 2020 is reduced to a loss of $10,000. The $10,000 loss is then subtracted from Beans' taxable income under subpart IC. The time for the person to notify the Commissioner of the election is extended until the time for filing the 2021 income tax return. Saddles' remaining $25,000 of 2021-year loss, and all of Blazing's loss, can be used to offset Beans' 2021-year income.

Company	2019–20 pre group offset	2019–20 post group offset	2020–21 estimated position	2019–20 post loss carry back
Beans	$100,000	$40,000	$75,000	$30,000
Blazing	$(60,000)	NIL	$(50,000)	NIL
Saddles	$40,000	$40,000	$(75,000)	NIL
Total	$80,000	$80,000	$(50,000)	$30,000

NEW LEGISLATION

Example 6

The facts are the same as in example 5 but suppose that Beans' income for the 2021 year is made up of a $36,000 fully imputed cash dividend, and $25,000 of other income. The imputation credit satisfies the liability to pay tax on $50,000 of income. So, the group position for 2019–20 would be:

Beans	$ 25,000	(that is, $75,000 less $50,000 sheltered by the ICs)
Blazing	$ (50,000)	
Saddles	$ (75,000)	
Total	$(100,000)	

Accordingly, the excess loss as defined in subsection (3)(b) is increased by $50,000. This allows all of Saddles' loss to be carried back. This means that Saddles has a tax loss of $35,000 (that is, $40,000 – $75,000) in the 2019–20 year, all of which can be subtracted from Beans' $40,000 of taxable income. Now Blazing can also carry back $5,000 (being the $80,000 income from the 2019–20 year which is the maximum amount that can be carried back as above less the $75,000 loss carried back by Saddles), and this amount can similarly be subtracted from Beans' taxable income. The Beans Group will end up with a full refund of its 2019–20-year tax provisional tax, and Blazing will have a $45,000 loss able to be carried forward in the 2020–21 income year.

Taxpayers are able to claim a refund for a loss carry-back by re-estimating provisional tax (where 2019–20 is the taxable income year) or amending their tax return (where 2018–19 is the taxable income year).[1] The deadline for re-estimating provisional tax has been extended from the final instalment date until the date the tax return is filed (or the due date if this is earlier). This allows taxpayers to have time to consider the estimate of their tax loss for the net loss year.

For example, if a company is in profit for 2019–20 and estimates it would be in loss in 2020–21, it can re-estimate its 2019–20 provisional tax by taking into account the estimated loss carry-back deduction. It can do this any time up to the earlier of:

- the day the 2019–20 tax return is filed; or
- the day the 2019–20 tax return is due.

Provisional tax already paid can then be refunded. The provision also extends to shareholder-employees of a company who may have paid provisional tax on the basis that they would receive a shareholder salary from the company which is not in fact paid because the company's pre-salary income is offset by a loss carry-back.

If the tax return for the profit year has already been filed, the taxpayer is able to request a reassessment and refund because of the loss carry-back.

Example 7

Eagle Beach Kayaking Ltd (Eagle) operates kayaking tours in Abel Tasman National Park and makes the majority of its income for the year in the summer months. The company experienced a significant reduction in bookings and a number of cancellations from early December 2019 as a result of COVID-19 which has resulted in it making a loss for the year ended 31 March 2020 of $70,000. In the prior year the company made a taxable profit of $95,000 and paid tax of $26,600. Eagle filed its 2018–19 tax return in December 2019.

Eagle is eligible for the loss carry-back scheme and is entitled to carry its 2020 loss back to the 2019 year. To do so Eagle will need to amend its tax return for the year ended 31 March 2019 to receive a refund of the overpaid tax in 2019. Eagle amends its 2019 tax return via myIR and receives a refund of $19,600 (($95,000 – $70,000) × 28% less tax paid of $26,600). Alternatively, Eagle could request the Commissioner accept a section 113 of the Tax Administration Act 1994 adjustment in writing, requesting the amendment of its 2019 tax return.

At the time it amended its return Eagle filed an interim imputation credit account (ICA) account which shows a balance in its ICA of $20,500 on the date of the refund and after the refund will have a credit balance of $900. However, if Eagle only had a balance in its ICA of $15,000, the amount of the refund will be restricted to $15,000. This will mean that Eagle will have $4,600 held in its income tax account to use towards other income tax debts or future income tax payments.

Almost all types of taxpayers are eligible to carry back losses (companies, trusts, and individuals). The majority of individuals who are taxed through the PAYE system and are subject to auto-calculation (qualifying individuals) do not have losses so would be unaffected by this measure, but those that operate businesses through partnerships, limited partnerships, and look-through companies would be able to benefit. Taxpayers who have ringfenced rental losses would also not be able to carry back losses.

[1] Technically it would be possible to also claim a loss carry-back in a 2019–20 income tax return when that was filed, although this will delay the ability to obtain a refund of overpaid provisional tax.

Example 8

For the year ended 31 March 2019 Michael paid tax of $21,940 on $94,000 of income, all of which related to wages and interest income he earned during the year. Michael was therefore a "qualifying individual" in the 2019 income year.

In the year ended 31 March 2020 Michael entered into a partnership with Gus, running a small accounting advisory firm – Michael And Gus Accounting (MAGA). Michael and Gus's partnership made an $80,000 loss in the 2020 income year as it was still a new business with a small number of clients, and it was challenging establishing itself post-COVID-19. Each partner was allocated $40,000 of the partnership's loss to include in their 2020 tax return. After including his other income, Michael has a net loss of $25,000 for 2020.

The loss carry-back scheme does not apply to individuals who are qualifying individuals in the loss year. As Michael was not a qualifying individual in the loss year (the 2020 income year), Michael is eligible to carry his $25,000 loss back to the 2019 income year. This will now make his taxable income $69,000, with tax thereon of $13,720, Michael will receive a refund of $8,220 ($21,940 – $13,720) after amending his return through myIR.

Michael would not be eligible if he only received reportable income such as salary, wages and dividends in the 2020 loss year as it would be impossible for him to have a loss.

Example 9

Katherine owns a number of residential rental properties. In the year ended 31 March 2020 she paid $17,320 of tax on her net rental income of $80,000.

In the year ended 31 March 2021 Katherine reduced the rent she was charging her tenants as, because of COVID-19, the majority could not continue to afford to pay the same rent. Overall, Katherine only received $40,000 of rental income from tenants in the 2021 income year, however, her rental expenses largely remained the same and her total rental deductions for 2021 were $60,000. As a result, her rental properties made a loss of $20,000. Katherine wants to carry her $20,000 loss back to the 2020 income year under the new loss carry-back provision and cash out the loss she has made this year.

Under the ring-fencing of residential property rules, the amount of Katherine's rental deductions allowed is capped at the amount of rental income received (that is, $40,000) and her excess deductions will be carried forward to the 2022 income year. Katherine cannot carry her excess rental deductions back.

Multi-rate PIEs (most unit trusts and KiwiSaver funds) may not carry back losses. Multi-rate PIEs (including KiwiSaver) have tax cash-out for losses so already benefit from immediate tax relief for losses.

A restriction on the ability to carry back losses will also arise where a taxpayer has made charitable donations in the taxable income year. In that case the loss is limited to the amount of taxable income reduced by the amount of charitable donations for which that person has received a tax credit under subpart LD (tax credits for gifts and donations). This restriction will not apply to a company, as it does not receive a tax credit but a deduction for a charitable donation.

Charitable donations are only creditable up to the taxable income of a person. Allowing a loss carry-back will reduce taxable income of a person yet the credit for charitable donations will be unaffected. Section IZ 8(2)(a) will prevent a taxpayer carrying a loss back to the extent that the donations will exceed the revised taxable income of the person.

Example 10

Jack operates a handyman business as a sole trader. Jack was retired for most of 2019 but towards the end of the year decided to start up his handyman business to keep himself busy. As it was only operating for a few weeks during the last quarter of 2019, for the year ended 31 March 2019, Jack's business made a profit before tax of $5,000.

Jack decided to donate some of his small 2019 profit to a registered charity. He donated $3,000 for which he received a tax credit of $990 for charitable donations he made during the year.

For the year ended 31 March 2020 Jack's business made a $5,000 tax loss. He wants to know whether he can carry back the full 2020 tax loss to 2019.

As the loss carry back provisions do not allow a loss to be carried back and offset against income to the extent that the revised income would be less than the donations for which a tax credit has been claimed, Jack can only carry back $2,000 of his tax loss to the 2019 year. The balance of $3,000 can be carried forward to offset future years' profits.

Standard features from the tax system also apply and are therefore not specified within the Act. These include:

- To obtain a refund of income tax, an imputation credit account company must have an imputation credit account credit balance of at least the amount of the refund at the end of the most recently ended imputation year (meaning, that if a refund is requested for the 2018–19 year, it will be necessary to file an imputation return up to 31 March 2020), or alternatively it can complete an interim imputation return up to the date of the refund request (see example 7).
- If the loss carry-back is overestimated, resulting in tax to be paid later, standard use-of-money interest would apply in the normal way.

Example 11

Dorothy and Mary own Hidden Figures Limited (HFL) a company that makes model spacecraft. They have had a pretty good year to 31 March 2020 overall but had a terrible month of March because their main customer base is overseas visitors. Given the current COVID-19 situation and the expected worldwide decline in travel Dorothy and Mary do not see the financial position of the business improving until they get their online sales up and running or the tourist market gets back to previous levels.

They sit down and work out that even by cutting costs HFL will probably make a loss to 31 March 2021 of at least $1,200,000. In the 2019–20 income year HFL used the standard method to pay provisional tax. Its instalments for the year were $240,000 on both the 28th of August 2019 and 15th of January 2020. Dorothy and Mary have calculated that, pre-COVID, they think HFL was likely to make taxable income of $2,670,000 with tax payable on that of $747.600 and they were planning to make a final instalment of provisional tax on 7 May 2020 of $267,600.

They elect to carry back the anticipated loss from the 2020–21 income year to the 2019–20 income year. This will give them a revised taxable income of $1,470,000 ($2,670,000 – $1,200,000) and a tax liability of $411,600. At the third instalment they decide to estimate HFL's tax liability at $411,600 via myIR. This means there is no payment required at the third instalment date and Inland Revenue will issue HFL a refund of $68,400 ($480,000 – $411,600).

In October 2020 Dorothy and Mary realise that the business has been doing worse than expected and now anticipate the 2020–21 loss to be $1,700,000. When they are preparing HFL's 2019–20 income tax return they reflect this increased loss in the return and when they file they receive an additional refund of $140,000.[2]

However, when completing the 2020–21 tax return for HFL Dorothy and Mary calculate that the loss for the 2020–21 income year will only be $1,100,000 given the quick recovery of the tourist industry in the first quarter of calendar year 2021. They complete the 2020–21 return and then amend the 2019–20 return for HFL. The reduced loss will mean that HFL has taxable income of $1,570,000 ($2,670,000 – $1,100,000) and a residual income tax (RIT) liability of $439,600 in 2019–20. It has only paid tax of $271,600 so will have tax payable of $168,000. Interest will be calculated as follows:

	First instalment (P1)	Second instalment (P2)	Third instalment (P3)
One third of RIT	$146,533	$146,533	$146,533
Less paid at instalment date	($240,000)	($240,000)	NIL
Plus (less) excess prior instalment	NIL	($93,467)	($118,534)[3]
Amount subject to debit (credit) UOMI	($93,467)	($186,934)	$28,000 shortfall at P3 plus from October 2020 the refund amount of $140,000 (total $168,000)

- The loss carry-back must ultimately be supported by a net loss shown on a tax return filed for the loss year.
- If the tax return for the loss year is not filed, the loss carry-back deduction could be disallowed.
- If a loss company is a member of a group of companies, its loss can be carried back to the profit year and offset against the income of those other group companies. This requires that all of the companies in the group are 66% or more commonly owned from the beginning of the year of profit to the end of the year of loss, with provision made for part periods.
- Section RM 10(4) of the Income Tax Act 2007 has been amended so if the taxpayer owes a debt on other tax types, Inland Revenue will not apply any of the refund arising from the loss carry-back to satisfy tax debts.
- Where use-of-money interest applies because of an overestimate of the loss carry-back, the taxpayer cannot use the remission of interest provisions in section 183ABAB of the Tax Administration Act 1994.
- A taxpayer estimating their provisional tax to take advantage of the loss carry back scheme will not take provisional tax associates out of the interest concession rules in section 120KBB of the Tax Administration Act 1994.

[2] Calculated as ($2,670,000 – $1,700,000) × 28% = $271,600 – $411,600 = $140,000.

[3] Calculated as $25,067 overpayment from P1 ($93,467 less $68,400 refund) plus $93,467 from P2.

A new anti-avoidance provision has also been inserted as new section GB 3B. This would apply where a share in a company has been subject to an arrangement which allows a loss company to meet the requirements of the new section IZ 8 and the purpose of that arrangement is to defeat the intent of section IZ 8. Any arrangement subject to this provision would not be treated as meeting the requirements of section IZ 8.

An amendment has also been made so that sections GB 4(1)(b) and GB 4(2), which deal with arrangements for grouping tax losses for companies, would also apply to section IZ 8.

Example 12

Saturn Five Limited's (SFL) taxable income in the 2019–20 income year was $2 million. By August 2020, it becomes clear to the company's directors that, because of the impacts of COVID-19 on the company's trading activities, SFL is likely to have significant tax losses for the 2020–21 income year. The losses for the part-year to August 2020 are already $1 million. It is also clear to the directors that SFL needs a significant injection of funds to continue trading. The company directors identify a potential new investor, von Braun Limited (vBL).

The shares in SFL are 100% owned by Mr and Mrs Wernher. After a period of negotiation, the directors of SFL and Mr and Mrs X conclude a memorandum of understanding with VBL under which VBL will provide the necessary debt financing in addition to acquiring a controlling interest of 60% of the ordinary shares in SFL. Mr and Mrs Wernher will continue to hold the remaining 40% of the shares after the transaction is completed.

The parties realise that one effect of implementing this arrangement in August 2020 is that SFL would breach the continuity of ownership rules and therefore would not satisfy the requirements to permit an election under section IZ 8. This means that any losses incurred for the remaining part of the 2020–21 income year would be unable to be carried back. SFL's ability to carry losses back to the 2019–20 income year under section IZ 8 and the consequent tax refund could be maximised if any change in ownership does not occur during the 2020–21 income year.

Accordingly, when the arrangement is implemented in August 2020:

- VBL unconditionally agrees to acquire 60% of the ordinary shares of SFL as at the end of the 2020–21 income year (1 April 2021) at the same price as originally contemplated in the memorandum of understanding but with an adjustment of 50% of the tax relief arising from any additional tax losses available to SFL attributable to the period 1 June 2020 to 31 March 2021.
- VBL agrees to provide the capital injection immediately by way of a loan on interest-only terms and at market rates in return for debentures issued by SFL with security over the assets of the company.
- The loan principal advanced is the same amount of consideration VBL is required to pay for the shares under the agreement for sale and purchase of 60% of the shares in SFL.
- The loan arrangement is made on usual commercial terms, including lender protection:
  - to satisfy the share purchase price, VBL will assign the loan to Mr and Mrs X;
  - the directors of SFL resolve immediately to appoint to the board a director nominated by VBL.
- The shareholders of SFL, subject to the sale and purchase of the shares agreement with VBL, immediately enter into an agreement with VBL in which they agree not to exercise their shareholder decision-making rights in a way contrary to the directions and interests of VBL.

SFL's net loss for the 2020–21 income year is $1.8 million. SFL elects to apply section IZ 8 to carry the loss back to the 2019–20 income year.

This arrangement would be subject to section GB 3B. SFL is treated as not meeting the requirements of section IZ 8 from the date of the arrangement (while the losses up to the date of the arrangement may still meet those requirements). The shares in SFL are subject to an arrangement that enables the company to continue to meet the requirements of section IZ 8 for the entire 2020–21 income year. A purpose of the arrangement is to defeat the intent and application of section IZ 8 by preserving the ability to carry back the full amount of SFL's loss for that income year, while the commercial and economic reality of the arrangement is that VBL has immediately acquired a controlling interest in SFL as though the share sale had already taken place. This defeats the intent and application of the temporary loss carry-back regime.

The temporary loss carry back scheme is a response to the current COVID-19 situation and has the aim of assisting businesses with their cash flow issues during the period of reduced economic activity because of Alert Level 1–4 restrictions. However, some taxpayers may seek to take advantage of the provisions. General anti-avoidance provisions within the Income Tax Act 2007 may apply to transactions which seek to generate tax losses in order to benefit from the loss carry-back scheme.

Example 13

Dodgy Duke Tax Advisors Limited (Duke) works through the loss carry-back provisions and comes up with a scheme to get a timing advantage out of the loss carry-back provisions. One of the partners, Charles, identifies a number of clients who are generally unaffected by the COVID-19 situation but rent premises from associated companies.

Charles suggests to these clients that they increase the amounts the company pays in rent to the associated company to an excessive level in the 2020–21 income year which pushes the usually profitable businesses into a loss.

The clients then elect under section IZ 8 to carry back that loss to the 2019–20 year to obtain a refund of provisional tax for the year. This creates a timing advantage to the client as the client benefits from the refund in the 2019–20 income.

The integrity module within Inland Revenue's new START system flags this transaction as suspect for one of Duke's clients. The Commissioner undertakes an audit, discovering that for that one year the rent paid is excessive compared to prior years and market rates, with no particular reason for the increase other than to create a tax loss to carry back.

The Commissioner applies section BG 1 of the Income Tax Act 2007 to void the transactions to reverse the tax benefit of the advantage which is the amount of the rent that puts the company into a loss. Duke's client is also assessed shortfall penalties of 100% for taking an abusive tax position in respect of the transaction.

Example 14

C&S Modules Limited (CSM) is a company that provides cleaning and sterilising modules for decontaminating buildings from contamination including viruses. They are in hot demand as New Zealand approaches COVID-19 Alert Level 2. This should mean that most employees can go back to work.

They have only been minimally affected by COVID-19 during the lockdown and will see significant upside because of this increased demand for office and sterilisation services. CSM's accountant Deal 4 U Accounting Limited (D4U) takes a look through CSM's records to see if there is any way they can take advantage of the new loss carry-back provisions notwithstanding CSM has been largely unaffected by COVID-19 and is not expected to make a loss in the 2020–21 income year.

D4U notices that CSM has an item of specialised depreciable property in its tax fixed asset register that has a very high written down tax value compared to its market value. If CSM were to realise this loss it would tip it into an overall loss for 2021 of $10 million. Carrying this loss back to the 2019–20 income year will enable CSM to claim a refund of all of its $2.3 million of provisional tax paid in that year. It will also create a timing advantage for CSM in terms of provisional tax in future years.

D4U suggests that CSM sell the property to a company associated with D4U for the market value which will crystalise the loss in CSM. The day after, the associated company will sell the asset back to CSM for market value plus a share in the tax advantage obtained by CSM.

CSM undertakes this transaction and crystalises a tax loss of $10 million of which it carries back $8.2 million to the 2019–20 income year which is sufficient to allow it to receive a refund of its $2.3 million in provisional tax back.

Sometime later the Commissioner investigates CSM and notices this transaction. She applies GB 33 (arrangements involving depreciation loss) to the transaction which will result in the reversal of the tax advantage under the arrangement. She also imposes an abusive tax position shortfall penalty on CSM of 100% of the tax advantage.

In formulating the policy and operational guidelines on the loss carry-back scheme, officials consulted and presented the scheme to various interest groups and a number of questions on the new regime arose:

Frequently asked questions

Application process and timing

How do you ask for a refund where you use tax pooling to make tax payments and are yet to file the 2018–19 tax returns? Do you request the refund through the pooler or through Inland Revenue?

Using a tax pooler will allow you to have overpaid tax taken out of the pool at any stage, however, to claim a loss carry-back you will need to reflect that in your tax returns. If the 2018–19 return is yet to be filed, you can reflect the loss carry-back in the return rather than amending a filed return.

What about a look through company (LTC) that already had a loss in 2020 but expected a further loss in 2021? Can it carry back the loss from 2021 so it can pass on the higher loss to the shareholders?

For purposes of the Act, an LTC does not have a loss which it can push back or carry forward. Its owners have a share of any loss from its operations, just as for a partnership. If an LTC has a loss in 2020, that loss will be attributed to its owners in that year. If an owner has a net loss in 2020, then the owner will not be able to carry back a loss from 2021 to 2020. On the other hand, suppose an owner who in 2020 had other sources of income, such that the owner's share of the LTC's 2020 loss did not mean the owner had a net loss. This owner will be able to carry back the 2021 loss, including its share of the LTC loss, to 2020 for offset against its initial taxable income.

If you make a profit in 2020, but then a loss in 2021, can you still go back and recover tax paid in 2019?

No, under the temporary loss carry-back scheme you can only carry back a loss to the immediately preceding year. A 2021 loss can only be carried back to 2020. Similarly, a 2020 loss can only be carried back to 2019.

Two companies with 100% the same shareholding both made a loss in the 2020 year. Under normal rules, there is no offset/ subvention as both made losses. As one of the companies made a profit in the 2019 year, can we use the losses from both companies to claim back 2019 tax paid from the one company?

Yes, to the extent of the net income of the group in the 2019 year and subject to the loss continuity rules.

What if you don't need to carry back the entire loss so some would be carried back and some would be carried forward?

Yes, you would only elect for the amount you wanted to carry back to be carried back and the remaining losses will carry forward subject to the usual loss rules.

Eligibility and tax types (including provisional tax)

Will loss carry-back apply to non-residents (for example, Australians with property ownership apartments in commercial hotels that operate as a partnership in New Zealand and file an IR3NR)?

Yes, there is no restriction on non-residents carrying back a loss to offset other New Zealand sourced income in the prior year.

What about companies paying provisional tax using the GST ratio method?

Taxpayers who use the GST ratio method can carry a loss back but they will need to become an estimator for provisional tax purposes under the temporary loss carry-back scheme. Unlike taxpayers who are using the accounting income method (AIM) who can have a loss carry-back without exiting the AIM method.

Are expected partnership losses able to be carried back by a partner limited to the expected investment basis in the partnership?

This will depend on the type of partnership. You can only carry back a loss as calculated under the other rules in the Act. If an expense or loss incurred in a year is not deductible until a later year, then that expense will obviously not be part of any loss in the year it is incurred, and therefore will not be able to be carried back. Similarly, all the partnership rules will apply so if the partner is unable to attribute losses from a partnership because they exceed their investment basis this rule will apply to limit the amount of losses able to be carried back.

Does the requirement to offset losses in a group before carrying a loss back apply if the companies are not part of a consolidated group?

Yes, it will apply to a wholly owned group in the loss year whether or not they are a consolidated group.

Shareholder employees

Do you opt-in for shareholder employees that you intend estimating the 2020 provisional tax and getting a refund of overpaid 2020 provisional tax or do you opt-in for the company that will incur the 2021 loss and bring this back to 2020 and reduce salaries as a result?

Although only the company would undertake a loss carry-back practically within the system you will need to opt-in for both the shareholder employee and the company to enable the overpaid provisional tax paid by the shareholder to be refunded.

For companies, will you be allowed to equalise the shareholder salaries between years by declaring a salary in the loss year which creates a loss to carry back?

It is likely that such a transaction would not be economically viable, however, it is likely that sections BG 1 or GB 25 would apply to such payments. An abusive tax position penalty of 100% could also apply.

Rental losses

Can domestic rental losses be carried back or does ring-fencing override?

No, for losses that are ring-fenced in a given year there is no deduction in that year (the expenditure is carried forward) and therefore no loss to carry back to the prior year.

Will Inland Revenue revisit the ring-fencing of rental losses for LTCs given the impact to landlords under COVID-19?

At this time no changes are expected to be made to the loss ring-fencing rules as a result of COVID-19.

Interest and penalties

Are there potentially late payment penalties as well, for a person who pays tax on the basis of an estimated loss carry-back that does not eventuate, or is smaller than estimated?

This will depend on the nature of the underpayment and the provisional tax method the person is using. For a taxpayer who estimates and has paid the estimated amount no late payment penalties should arise although the taxpayer will need to take reasonable care in making their estimate. This will be the case even if they end up with a higher tax liability because of an overestimate of a loss to carry back as long as they have paid the amount of the estimate.

For taxpayers using the standard uplift method and who have overestimated their loss carry-back late payment penalties may apply where they have not paid at least the lower of their instalment amount or RIT.

Social policy

What impact will a loss carry-back have on family assistance, child support and student loans?

The carry back of a loss will have no effect on working for families or student loan obligations, but it may have an effect on child support payments.

More practical information on how to claim a loss carry-back and how the scheme works in practice is available at **www.ird.govt.nz/covid-19/business-and-organisations/temporary-loss-carry-back-scheme**

Administrative flexibility

Sections 3, 6H, and 6I of the Tax Administration Act 1994

New sections 6H and 6I of the Tax Administration Act 1994 introduce a temporary discretionary power the Commissioner may use to provide flexibility for due dates, deadlines, time periods, timeframes or procedural and administrative requirements for taxpayers who are affected by COVID-19, making compliance with current tax obligations impossible, impractical, or unreasonable.

The discretionary power is intended to provide the Commissioner with a timelier mechanism to assist taxpayers who encounter practical difficulties in complying with certain requirements under the Inland Revenue Acts, or under provisions in the Unclaimed Money Act 1971. The power is intended to supplement existing provisions already available to taxpayers affected by COVID-19. That is, where there is existing time flexibility provided in other provisions, these provisions will be used instead.

Where taxpayers comply with a modified timeframe or requirement made under this power, they will be treated as if they complied with the requirement set in legislation. The variations are intended to be exercised in a way that provide taxpayers with more time or options, that is, the measure is taxpayer-friendly and taxpayers may choose whether or not to comply with a variation or with requirements set in legislation.

Background

The Commissioner of Inland Revenue is charged with the administration of the Inland Revenue Acts. As part of that administration, the Commissioner must use her best endeavours to protect the integrity of the tax system.

There is existing flexibility for the Commissioner to accommodate taxpayers affected by COVID-19. This includes the ability for the Commissioner to remit late filing penalties or use-of-money interest when a taxpayer files or pays late and is affected by COVID-19, to change some dates by Order in Council or the Commissioner's care and management power.

Given the process and time required for an Order in Council, and the concern that existing provisions may be unable to resolve particular difficulties, providing a time-limited discretion to allow the Commissioner to extend due dates and timeframes or to modify other procedural requirements is a more efficient way to respond quickly and provide relief to those affected by COVID-19.

This new discretionary power will be used for situations where it may be impossible, impractical or unreasonable for taxpayers to comply with requirements because of the impacts of COVID-19 and where the Commissioner considers an appropriate outcome is not possible or is difficult to achieve under a current provision.

Key features

The Act introduces a temporary discretionary power for the Commissioner to issue a COVID-19 response variation.

It allows the Commissioner to:

- extend a due date, deadline, time period or timeframe in relation to a requirement; and
- modify a procedural or administrative requirement that must be met under a provision, for example, modifying the nature or form of information that is required to meet the provision.

If a taxpayer complies with an alternative set out in a variation they would be treated as if they complied with the requirements set out in legislation.

Variations must be made within and relate to the approximately 18-month period from 17 March 2020 to 30 September 2021. This limit recognises that this is a discretionary power conveyed on the Commissioner for the purpose of assisting taxpayers with certain compliance issues in the wake of COVID-19.

Application dates

The amendment applies from enactment and may be exercised for obligations which arose from 17 March 2020. The discretion only applies until 30 September 2021 for dates and variations within that timeframe.

The discretion can be further extended by Order in Council, as set out in S6H(4), if this is required to account for ongoing effects of COVID-19.

Detailed analysis

Section 6I(1) provides the Commissioner with a discretionary power to vary due date, deadlines, time periods, timeframes and administrative or procedural requirements for taxpayers who are adversely affected by COVID-19.

It allows the Commissioner discretion to:

- extend a due date, deadline, time period, or timeframe in relation to a requirement (section 6I(1)(a)); and
- modify a procedural or administrative requirement that must be met under a provision, for example, modifying the nature of form of information that is a requirement to meet the provision (section 6I(1)(b)).

Extension of due dates, deadlines, timeframes or time periods (section 6I(1)(a))

This allows the Commissioner to use her discretion for due dates, timeframes or time periods specified in provisions. The Commissioner may extend a due date, deadline, time period, or timeframe by, within, or, in relation to which:

- a person must comply with a requirement set out in the provision;
- a person must make an election under the provision; and
- a person's entitlements, rights or obligations are affected.

Example 15

A taxpayer is required to notify the Commissioner of an election by 30 May in order to opt into the XYZ regime. The election includes certain information on the taxpayer's business. For some taxpayers these records may be only readily accessible from a taxpayer's business premises.

Given Level 4 and Level 3 restrictions taxpayers are likely to have had limited time where they were able to access their business premises. Recognising this, and that focus is likely to be on setting up businesses for re-opening, the Commissioner chooses to exercise her discretion in accordance with section 6I(1)(a)(b) for the due date for elections to be made to 30 June.

The Commissioner issues instructions on this variation on the Inland Revenue website, including that the taxpayer is not required to separately inform the Commissioner that they will be providing this information after 30 May if they make the election by 30 June.

If a taxpayer makes the election to opt into the XYZ regime by 30 June, they will be treated as if they met the requirement to make the election by 30 May.

Modify a procedural or administrative requirement (section 6I(1)(b))

The Commissioner also has the power to modify a procedural or administrative requirement that a person must meet under a provision of the Inland Revenue Acts or the Unclaimed Money Act 1971. This may relate to how a taxpayer is required to provide something, for example, in what form information must be provided.

Example 16

A taxpayer is required to make a declaration to the Commissioner which includes supporting evidence, including proof of address which must be provided by a specific agency. Because of COVID-19 the agency is experiencing backlog and is unable to process information requests in a timely manner. The Commissioner considers this requirement may therefore be currently impractical for taxpayers to comply with and comes to the view that proof of address may be provided in a different form, such as by a copy of an addressed letter from a utilities company.

A variation in accordance with section 6I(1)(b) is provided which states alternative forms of proof of address which are acceptable for this provision for declarations made until 30 November 2020.

If the taxpayer complies with an alternative set out in this variation, they are treated as meeting the information requirements set out in the relevant legislation.

The discretionary power does not extend to an ability to vary rates of tax or change a tax liability. The exercise of a discretionary power may, however, affect a person's tax liability (if, for example, the due date by which a person must do something in order to avoid a liability, or time period that triggers particular consequences, is extended).

When the Commissioner can exercise the discretion (supplementary nature)

Section 6H sets out the purpose of the discretion, including how it will be used within the framework of existing provisions which provide relief or flexibility. The Commissioner can exercise the power at her discretion, consistent with her obligations to maintain the integrity of the tax system, when current requirements are likely to be either impossible, impractical or unreasonable to meet.

The provision is intended to ensure the Commissioner can exercise sufficient flexibility across tax types and compliance requirements to account for practical compliance concerns arising from COVID-19. However, discretion under the power is intended to be used where the Commissioner considers an appropriate outcome is either not possible or may be difficult to achieve under the terms of the existing provisions. Existing provisions include recently introduced rules around the remission of use of money interest and the Commissioner's care and management provision. This is reflected in subsection 6H(3).

Temporary application over an 18-month period

Subsection 6H(4) provides that the Commissioner may exercise discretion under this provision for a period of approximately 18 months. This applies for dates, timeframes or requirements that may arise for a taxpayer over this 18-and-a-half-month period, ending on 30 September 2021. Any variation made must be confined to obligations or dates that occur within this period.

In addition, subsection 6H(4) provides that this timeframe could be extended through an Order in Council on recommendation by the Minister of Revenue, if that is required for longer lasting effects of COVID-19.

Applies to taxpayers affected by COVID-19

Subsection 6H(2) provides that the Commissioner could exercise this discretion where compliance with current requirements is impossible, impractical or unreasonable, because of circumstances arising from COVID 19 or response measures to COVID-19, including by the Government.

Section 6I(3) provides that a variation applies generally unless the Commissioner specifies that it applies to a specific class of taxpayers or if specific circumstances or conditions are required. The intention is where taxpayers are in a similar position, they should be able to access the same variation of requirements.

This would provide consistency across taxpayers in similar situations where they are affected by COVID-19 and allow Inland Revenue to automatically apply the benefit of a variation for a group of affected taxpayers, for example, an extension of a due date or time period, as variations would only be advantageous to taxpayers.

Taxpayers may choose whether or not to comply with variation or existing requirements

COVID-19 variations are intended to either provide taxpayers with more time or modify a procedural or administrative requirement in a way that provides additional options or less onerous compliance requirements to recognise the impact of COVID-19 circumstances.

However, taxpayers may always choose to comply in the way set out in the legislation rather than in line with any published variation. This ensures the measure is taxpayer friendly.

Subsection 6I(4) achieves this optionality by providing that taxpayers who are covered by a variation may elect whether or not to use it by either informing the Commissioner or taking a tax position that reflects their choice. Generally, we expect taxpayers will not need to separately inform the Commissioner and may act in accordance with the variation.

Subsection 6I(2) provides that where taxpayers comply with a variation made under this power, they would be treated as if they complied with the requirement set in legislation.

A variation does not change an underlying due date or requirement. However, if a variation is available to a taxpayer and they comply with it they would be treated, through subsection 6I(2), as if they complied with the requirement set out in legislation.

If a taxpayer is still unable to comply with a variation, they should contact Inland Revenue to discuss their circumstances.

The Commissioner will publish details of a varied requirement

Subsection 6I(5) requires the Commissioner to publish any variation made using this discretion. This is intended to provide information in a central place, such as the Inland Revenue website, to communicate the COVID-19 variations to any affected taxpayers.

Publishing this information provides transparency and will help promote consistency for treatment of taxpayers in similar positions. Variations will be published on our website at **www.taxtechnical.ird.govt.nz/apply-for/legislation-modification/covid-19-response-variations**

Amendment to confirm the exercise of this discretion is not a disputable decision

Amendments to the definition of disputable decision in section 3 of the Tax Administration Act 1994 provide that the decision to issue, or to decline to issue, a variation under section 6I is not a disputable decision.

Extension of the meaning of the Inland Revenue Acts

Subsection 6H(1) clarifies that the discretion can be exercised for any provision in the Inland Revenue Acts listed in schedule 1 of the Tax Administration Act 1994. Subsection 6H(5) extends the definition of the Inland Revenue Acts for this purpose to include the Unclaimed Money Act 1971.

This is to ensure that where appropriate, the Commissioner may exercise this discretion for the provisions of the Unclaimed Money Act 1971 that Inland Revenue administers.

COVID-19 New Zealanders Stranded Overseas Support Ministerial welfare programme

Sections CW 33, MD 6, and YA 1 of the Income Tax Act 2007; section 80KK of the Tax Administration Act 1994; and sections 2, 9, 27, 35A, and 142 of the Child Support Act 1991

The Income Tax Act 2007 and Tax Administration Act 1994 have been amended to ensure that payments made under the COVID-19 New Zealanders Stranded Overseas Support (NZSOS) Ministerial welfare programme in lieu of another payment normally payable under the Social Security Act 2018, New Zealand Superannuation and Retirement Income Act 2001, or Veteran's Support Act 2014 are subject to the same tax treatment as those payments.

Amendments to the Child Support Act 1991 also ensure that when such payments are made and the person is a receiving carer for child support the usual child support rules apply.

Background

On 17 April 2020, the Minister for Social Development made a Ministerial welfare programme under section 101 of the Social Security Act 2018 for beneficiaries and superannuitants stranded overseas as a result of COVID-19 (COVID-19 NZSOS programme).[4] Payments under the COVID-19 NZSOS programme began on 20 April 2020.

[4] The Ministerial welfare programme is available at **www.msd.govt.nz/documents/about-msd-and-our-work/about-msd/legislation/notice-of-change/2020/new-zealanders-stranded-overseas-programme.pdf**

The COVID-19 NZSOS programme allows the Ministry of Social Development to make payments to individuals who cannot otherwise receive their standard payment because they are stranded overseas as a consequence of COVID-19. These payments are equivalent to what the individual would otherwise receive had they been able to return to New Zealand and the intention is that there should be no difference for the recipient in terms of the tax treatment and associated obligations.

The COVID-19 NZSOS programme covers the following payments:

- main benefits payable under the Social Security Act 2018;
- orphan's benefit and unsupported child's benefit payable under the Social Security Act 2018;
- New Zealand superannuation payable under the New Zealand Superannuation and Retirement Income Act 2001;
- veteran's pension payable under the Veteran's Support Act 2014; and
- supplementary assistance.[5]

Under section CF 1 of the Income Tax Act 2007, income-tested benefits (defined term that covers the same payments as the term main benefit), New Zealand superannuation and veteran's pension are currently subject to income tax. All other monetary benefits payable under the Social Security Act 2018 (excluding income-tested benefits) are exempt from income tax under section CW 33.

Key features

The Act amends the definitions of income-tested benefit, New Zealand superannuation and veteran's pension in section YA 1 of the Income Tax Act 2007 to include the equivalent payments made under the COVID-19 NZSOS programme, by introducing new defined terms "main benefit equivalent assistance", "New Zealand superannuation equivalent assistance", "veteran's pension equivalent assistance", and "COVID-19 New Zealanders Stranded Overseas Support Programme".

These ensure that:

- individuals in receipt of COVID-19 NZSOS payments are subject to the same income tax rules as if they had received their income-tested benefit, New Zealand superannuation or veteran's pension directly;
- the Ministry of Social Development (MSD) is required to deduct and pay the relevant PAYE to Inland Revenue as is currently required with income-tested benefits, New Zealand superannuation and veteran's pension;
- an individual's entitlement to Working for Families tax credits is not impacted and MSD can continue to pay the family tax credit and Best Start credit to COVID-19 NZSOS recipients who would otherwise be eligible; and
- student loan repayment obligations remain the same.

Other payments made under the COVID-19 NZSOS programme are made in lieu of payments and benefits that are exempt from tax. These remain exempt from tax under section CW 33 of the Income Tax Act 2007.

While orphan's benefit and unsupported child's benefit remain exempt from income tax, the Act adds definitions of these terms to section YA 1 to ensure that their equivalent COVID-19 NZSOS payments are appropriately considered for Working for Families purposes.

The amendments to the Child Support Act 1991 ensure that:

- child support payments made to receiving carers who receive NZSOS payments equivalent to the sole parent rate of benefit or the unsupported child's benefit, continue to be retained to offset the cost of that benefit to the Crown; and
- the correct living allowance is applied to those receiving the equivalent of a supported living payment.

[5] Defined in clause 2 of the COVID-19 NZSOS programme as:
(a) Accommodation Supplement;
(b) Child Disability Allowance;
(c) Disability Allowance;
(d) Orphan's Benefit;
(e) Special Benefit;
(f) Special Disability Allowance;
(g) Temporary Additional Support;
(h) Unsupported Child's Benefit;
(i) Winter Energy Payment; and

Temporary Accommodation Assistance, Transitional Assistance Payment and Transitional Subsidy paid under the Ministerial Welfare Programme of those names.

Application date

The amendments apply from 20 April 2020.

Detailed analysis

The intent of the amendments is to ensure that an individual in receipt of a COVID-19 NZSOS payment is subject to the same tax treatment, Working for Families entitlements, and student loan and child support obligations that apply for their normal benefit, pension or supplementary assistance payment.

Changes to definitions

Several new defined terms are added to section YA 1 of the Income Tax Act 2007 and some existing definitions are amended to achieve this.

The new defined term "COVID-19 New Zealanders Stranded Overseas Support Programme" in section YA 1 is a reference to the COVID-19 NZSOS programme made under section 101 of the Social Security Act 2018 and forms the basis of the new defined terms:

- main benefit equivalent assistance;
- New Zealand superannuation equivalent assistance;
- veteran's pension equivalent assistance;
- orphan's benefit equivalent assistance; and
- unsupported child's benefit equivalent assistance.

These new definitions refer to the specific clauses in the COVID-19 NZSOS programme under which the relevant equivalent payments are made:

- payments equivalent to veteran's pension and New Zealand superannuation are provided for in clause 10 of the programme;
- payments equivalent main benefits/income-tested benefits are provided for in clause 11; and
- payments equivalent to supplementary assistance (including orphan's benefit and unsupported child's benefit) are provided for in clause 12.

As some individuals may have already lost their entitlement to their benefit or pension prior to 20 April 2020, clause 9 of the COVID-19 NZSOS programme enables MSD to make a lump-sum payment to the individual for this period.

The new equivalent assistance definitions therefore refer to both clause 9 and either clause 10, 11 or 12.

The definition of income-tested benefit has been amended to include main benefit equivalent assistance, the definition of New Zealand superannuation to include New Zealand superannuation equivalent assistance, and the definition of veteran's pension to include veteran's pension equivalent assistance.

Previously, orphan's benefit and unsupported child's benefit were undefined terms but appeared in section MD 6, the definition of dependent child in section YA 1 and in section 80KK of the Tax Administration Act 1994. The Act removes these in-text section references and introduces new definitions of orphan's benefit and unsupported child's benefit in section YA 1, which respectively include the new terms orphan's benefit equivalent assistance and unsupported child's benefit assistance.

An amendment to the definition of financially independent in section YA 1 has also been made to ensure all payments made under the COVID-19 NZSOS programme are covered.

Impact of definitional changes and other changes

One result of these definitional changes is that the main benefit equivalent assistance, New Zealand superannuation equivalent assistance, and veteran's pension equivalent assistance are taxed as income under section CF 1(1) and are subject to the PAYE rules under section RD 5(6). This means that when MSD makes a COVID-19 NZSOS payment that is paid instead of an income-tested benefit, New Zealand superannuation or veteran's pension, they are required to account for PAYE on the payment as they normally would with a pension or benefit.

Monetary benefits payable under the Social Security Act 2018 are exempt income under section CW 33(1), including amounts payable under a section 101 Ministerial welfare programme. There is a pre-existing exclusion for income-tested benefits, which now includes main benefit equivalent assistance. The Act makes two additional exclusions to cover New Zealand superannuation equivalent assistance and veteran's pension assistance. This ensures that these payments are taxable under section CF 1 and not exempt under section CW 33.

This means that for an individual normally in receipt of a benefit or pension, there is no difference in treatment when they receive a COVID-19 NZSOS payment instead.

For the purposes of the Working for Families rules, the term "social assistance payment" is defined in section MA 8 as meaning income-tested benefits, New Zealand superannuation and veteran's pension. Through the amendments to these three definitions, an individual in receipt of the equivalent payments under the COVID-19 NZSOS programme is entitled to the same Working for Families tax credits as if they had received their normal benefit or pension instead.

As the definitions used in the Income Tax Act 2007 flow through into the Tax Administration Act 1994, MSD are able to continue paying the Best Start and family tax credits to eligible individuals.

As the Student Loan Scheme Act 2011 also uses the definitions from the Income Tax Act 2007, the amendments ensure there is no difference in student loan obligations.

The changes to the Child Support Act 1991 ensure that when MSD makes a COVID-19 NZSOS payment that is paid to a sole parent beneficiary or recipient of an unsupported child's benefit, the child support rules apply as they would normally.

The amendments ensure that:

- Child support payments made to receiving carers who receive NZSOS payments equivalent to the sole parent rate of benefit or the unsupported child's benefit, continue to be retained to offset the cost of that benefit to the Crown.
- Recipients of NZSOS payments that are equivalent to a supported living payment continue to receive the higher rate of living allowance.
- Recipient of NZSOS payments equivalent to an unsupported child's benefit are still required to apply for child support only for the child(ren) for whom they receive the unsupported child's benefit, unless they receive any other social security benefit.
- Recipients of NZSOS payments equivalent to benefits paid at sole parent rate or unsupported child's benefit are not be able withdraw from child support.
- Child support payments for child(ren) for whom an unsupported child's benefit is paid continue to be distributed separately to child support payments made for any other children for whom the carer receives a social security benefit.

Small Business Cashflow Scheme

Sections CW 33, DF 1, EW 45, MB 13, and YA 1 of the Income Tax Act 2007; sections 3, 7AA, 157, and schedule 7 of the Tax Administration Act 1994

The Acts provide authorisation for the Commissioner to grant loans under the Small Business Cashflow Scheme (SBCS) and to administer the scheme on behalf of the Government.

A further provision enables information sharing between Inland Revenue and the Ministry of Social Development for the purposes of the administration of the loan scheme.

Background

The Acts contain a number of amendments to support the SBCS, to assist small to medium businesses who are adversely affected by COVID-19.

The SBCS is to be administered by Inland Revenue and the Acts make a number of amendments to support the administration of the SBCS.

More detailed information on the operation of the SBCS is available at **www.ird.govt.nz/covid-19/business-and-organisations/small-business-cashflow-loan**

Key features

The Acts provide for a number of amendments to support the SBCS:

- The insertion of a new section 7AA of the Tax Administration Act 1994 which authorises the Commissioner of Inland Revenue to enter into a loan contract with an applicant and permits the exchange of information relating to a wage subsidy scheme between the Ministry for Social Development (MSD) and Inland Revenue.[6]

[6] The COVID-19 Response (Taxation and Other Regulatory Urgent Measures) Act 2020 first introduced the information sharing provision to schedule 7 of the Tax Administration Act 1994. The COVID-19 Response (Further Management Measures) Legislation Act 2020 incorporated the information sharing provision into section 7AA and repealed the equivalent provision in schedule 7. These changes ensure that the information sharing powers are wide enough for the purposes of the administration of the loan scheme.

NEW LEGISLATION

- An amendment to the definition of tax in section 3 of the Tax Administration Act 1994 to allow Inland Revenue to use its existing debt management and care and management powers to administer the loan.
- Amendments to the Income Tax Act 2007 to ensure that expenditure funded by the loan is subject to the normal deductibility rules and interest on the loan will not be subject to resident withholding tax and the loan is not counted as income for Working for Families.

Application dates

The amendments apply from 30 April 2020.

Detailed analysis

The COVID-19 Response (Taxation and Other Regulatory Urgent Measures) Act 2020 inserts a new section 7AA into the Tax Administration Act 1994 to give the Commissioner of Inland Revenue the ability to enter into a loan agreement with an applicant under the SBCS. It provides for the Commissioner to be able to receive information from the applicant for the loan and the repayment of the loan where the applicant does not meet any criteria for the SBCS.

It also provides for a loan contract issued by the Commissioner not to be a credit contract or a consumer contract for the purposes of the Credit Contracts and Consumer Finance Act 2003.

Section 7AA of the Tax Administration Act 1994 also provides for the facilitation of the exchange of information between Inland Revenue and the Ministry of Social Development for the purpose of administering the SBCS.

It provides for the exchange of information for the wage subsidy scheme. The Commissioner will be able to use this information in connection with any of the Commissioner's duties, powers or functions under the Inland Revenue Acts.

To ensure the application of the information sharing provision is wide enough for Inland Revenue to use the information effectively, the COVID-19 Response (Further Management Measures) Legislation Act 2020 moved the provision to section 7AA, repealing the amendments made to schedule 7 in the process.

Two amendments are also made to the Income Tax Act 2007. Section DF1(1)(cb) is added to ensure that business expenditure that is funded by the loan is not subject to the restrictions on deductibility that apply to expenditure financed by certain government grants and loans. Instead, the normal deductibility rules apply to the business expenditure.

The second amendment ensures that if conversion to a grant occurs this does not trigger debt forgiveness income under the financial arrangement rules. Section EW 45 is amended to include any release from an obligation to repay the SBCS loan through conversion to a grant. This will ensure the base price adjustment does not result in taxable income.

The COVID-19 Response (Further Management Measures) Legislation Act 2020 (Response Act) contains further amendments to support the SBCS. It amends section MB 13 of the Income Tax Act 2007 to ensure that loan amounts are not counted as family scheme income for Working for Families purposes.

It also amends the definition of exempt interest in section YA 1 to ensure that interest payments made under the SBCS will not be subject to resident withholding tax.

The Response Act also makes amendments to the Tax Administration Act 1994 including in the definition of "tax" an amount payable under the SBSC to ensure that the Commissioner can use her care and management and debt management provisions to assist in the administration of the SBSC.

Amendments are also made to the definition of Small Business Cashflow Scheme and wage subsidy scheme.

Tax Administration (Write Off Amount) Order 2020

As part of the response to financial pressure on New Zealanders under COVID-19, the Government is increasing the threshold amount of individual income tax assessments written off from $50 to $200. This applies if the individual is subject to the rules in subpart 3B of the Tax Administration Act 1994 – commonly referred to as the auto-calculation rules.

Background

Income tax obligations for customers with only reportable income (income that has had tax withheld at source and is reported to Inland Revenue by the payers, for example, salary, wages and investment income) are automatically calculated by Inland Revenue. Customers are advised of the resulting refund or tax liability. Tax liabilities of $50 and under are automatically written off under the current rules.

Key features

Section 22J(3) of the Tax Administration Act 1994 provides for schedule 8, part B, clause 1 of the Tax Administration Act 1994 to be amended by Order in Council to change the amount of tax payable that may be written off by the Commissioner. The Order increases this threshold to $200.

Application date

The increase applies from 3 June 2020.

Tax Administration (Direct Credit of Refunds of Amounts in Income Equalisation Accounts and Environmental Restoration Accounts) Order 2020

Sections 184A and 184B of the Tax Administration Act 1994

The Tax Administration (Direct Credit of Refunds of Amounts in Income Equalisation Accounts and Environmental Restoration Accounts) Order 2020 makes the direct credit of refunds for income equalisation and environmental restoration accounts mandatory from 23 July 2020.

An Order in Council has been made to include refunds of amounts in income equalisation accounts and environmental restoration accounts as tax types refundable by direct credit under section 184A of the Tax Administration Act 1994.

The provisions in sections 184A and 184B require tax refunds to be paid via direct credit to a bank account nominated by the taxpayer and were introduced to benefit taxpayers by eliminating time delays associated with the postal system and costs related to cheques.

Tax Administration (Direct Credit of Refunds of Amounts in Income Equalisation Accounts and Environmental Restoration Accounts) Order 2020 mandates the direct credit of refunds of amounts in income equalisation accounts and environmental restoration accounts. Section 184A still allows the Commissioner to provide an exemption when direct crediting would cause undue hardship or is impracticable.

Background

Compulsory direct crediting for income tax and gaming machine duty was implemented when their administration was moved to Inland Revenue's new technology platform (START), which modernises and improves information flows, and enables more online self-service and automated processes.

Whilst the intent was that the Commissioner of Inland Revenue would eventually be required to direct credit all refunds of excess tax paid, the progressive implementation for various tax types through Orders in Council was legislated for to allow Inland Revenue the necessary flexibility to choose the optimal dates to implement direct crediting of refunds for each tax type.

Application date

The Order in Council comes into effect on 23 July 2020.

Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations 2020

Sections RA 21(3) and (4) of the Income Tax Act 2007

The fringe benefit tax (FBT) prescribed rate of interest for low-interest employment-related loans has been reduced from 5.26% to 4.50%.

Background

The FBT rules tax non-cash benefits provided to employees. Included in the definition of 'fringe benefit' is any employment-related loan on which the employer is charging a rate of interest that is below the market rate. The interest differential is taxable. A prescribed rate set by regulations is used as a proxy for the market rate of interest, to save employers the compliance costs associated with determining the market rate relevant to loans that they have provided to their employees.

Section RA 21(3) of the Income Tax Act 2007 permits the making of regulations by Order in Council to set a prescribed rate of interest for the purpose of calculating FBT on low-interest loans. Once a rate is set, it remains the prescribed rate until changed by a subsequent Order in Council.

By administrative convention, the FBT prescribed rate of interest is based on the 'floating first mortgage new customer housing rate' series published by the Reserve Bank (RBNZ) each month, and is updated when there has been an increase or decrease in the RBNZ rate of 20 or more basis points since the FBT rate was last set. The RBNZ rate for March 2020 was 4.50%, down from 5.26%, which had been the rate since August 2019. The FBT prescribed rate of interest is being lowered accordingly.

Application date

The new prescribed rate of 4.50% applies to the quarter beginning 1 July 2020, and subsequent quarters.

Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2019-20 Income Year) Order 2020

The deemed rate of return for taxing interests in foreign investment funds is 5.05% for the 2019–20 income year, down from 5.86% for the previous income year.

Background

The deemed rate of return is set annually and is one of the methods that can be used to calculate income from foreign investment fund interests. The rate is based on taking an average of the five-year Government bond rate at the end of each quarter, plus a margin of four percentage points.

Application date

The new rate was set by Order in Council on 6 July 2020 and came into force on 10 July 2020.

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.

COV 20/06: Variation to section EI 1 of the Income Tax Act 2007

Variation

The Commissioner of Inland Revenue has, under the discretion provided under section 6I of the Tax Administration Act 1994, made the following statutory variation:

Under s EI 1 of the Income Tax Act 2007, for a person to allocate timber income derived in an income year ending on a date between 25 March 2019 and 30 June 2019 to any one or more of the person's previous three income years, the date the application in writing must be received by the Commissioner is extended to 31 July 2020.

Application date

This variation applies from 18 June 2020 to 31 July 2020.

Dated at Wellington on 18 June 2020.

Martin Smith
Chief Tax Counsel
Inland Revenue

Background (material under this heading does not form part of the variation)

Summary of effect

1. This variation supplements COV 20/02 by extending the income years to which it applies to those ending between 25 March 2019 and 30 June 2019 rather than between 25 March 2019 and 31 May 2019.
2. Section EI 1 of the Income Tax Act 2007 allows a person to allocate income from the disposal of timber or right to take timber, or the disposal of land with standing timber, to previous income years. The income may be allocated between the income year in which it is derived and any 1 or more of the previous 3 income years. A person must apply in writing to the Commissioner no later than 1 year after the end of the income year in which they derive the income. The time for making that application, for income derived in an income year ending between 25 March 2019 and 30 June 2019, has been extended to 31 July 2020 using s 6I of the TAA.

Provisions affected

3. Section EI 1 of the Income Tax Act 2007.

Application of variation

4. This variation applies to a person who wishes to allocate to any 1 or more of the previous 3 income years timber income derived in an income year ending on a date between 25 March 2019 and 30 June 2019. Applications to allocate that income were due no later than one year after the end of the income year. The variation recognises that the impact of COVID-19 has adversely affected some taxpayers' ability to make an application on time, and would otherwise mean they are unable to spread the income to previous income years. For this reason, the due date for making the application has been extended.

References

Legislative references
Tax Administration Act 1994: ss 6H and 6I
Income Tax Act 2007: s EI 1

COV 20/07: Variation in relation to s 70C of the Tax Administration Act 1994 to extend deadline for filing statements in relation to R&D loss tax credits

Variation

The Commissioner of Inland Revenue has, under the discretion provided under section 6I of the Tax Administration Act 1994, made the following statutory variation:

For a statement in relation to R&D loss tax credits and R&D repayment tax for the 2019 tax year under s 70C of the Tax Administration Act 1994, the date by which that statement must be filed is extended to include a statement filed with the Commissioner on or before 31 August 2020.

This is subject to the condition that:

- This variation applies to taxpayers for whom the impacts of COVID-19 response measures or the consequences of COVID-19 had a material impact on them not filing the statements on time.

Application date

This variation applies from 1 April 2020 to 31 August 2020.

Dated at Wellington on 24 June 2020.

Martin Smith
Chief Tax Counsel
Inland Revenue

Background (material under this heading does not form part of the variation)

Summary of effect

1. Section 70C of the TAA requires a person to file a statement in relation to R&D loss tax credits or R&D repayment tax, no later than the earliest of the day on which they file a return of income for the relevant tax year, or the last day for filing a return of income for the tax year under s 37. For the 2019 tax year, the time within which a statement must be filed has been extended to 31 August 2020 using s 6I of the TAA.

Provisions affected

2. Section 70C of the Tax Administration Act 1994.

Application of variation

3. This variation applies to a person who wishes to file a statement in relation to R&D loss tax credits and R&D repayment tax for the 2019 tax year. The variation recognises that the impact of COVID-19 means that some taxpayers who would otherwise have filed a statement on time have been unable to do so. The variation is subject to the condition that it applies only to taxpayers for whom the impacts of COVID-19 response measures or the consequences of COVID-19 had a material impact on them not filing on time.

References

Legislative references
Tax Administration Act 1994: ss 6H and 6I
Tax Administration Act 1994: s 70C

COV 20/08: Variation in relation to the definition of "finance lease" in s YA 1 of the Income Tax Act 2007

Variation

The Commissioner of Inland Revenue has, under the discretion provided under section 6I of the Tax Administration Act 1994, made the following statutory variation:

> The time period of "more than 75% of the asset's estimated useful life" referred to in paragraph (b) of the definition of "finance lease" in s YA 1 of the Income Tax Act 2007 is extended to "more than 75% of the asset's estimated useful life plus an additional 18 months" where the term of the lease is extended between 14 February 2020 and 30 November 2020.

This variation is subject to the conditions that:

- The lease was entered into before 14 February 2020.
- The lease term was not more than 75% of the estimated useful life when the lease was entered into.
- The lease term is not extended more than 18 months beyond the end of its term as at 14 February 2020.
- The lease was extended because:
  - The lessee was prevented or discouraged from returning the lease asset at its scheduled maturity because of restrictions imposed in response to COVID-19; and/or
  - In the period between January 2020 and November 2020 the lessee's business has experienced a significant decline in actual (or predicted) revenue which means the lessee had difficulty satisfying their existing lease agreement; and that decline in actual or predicted revenue is related to COVID-19.

Application date

This variation applies from 17 March 2020 to 30 November 2020.

Dated at Wellington on 30 June 2020.

Martin Smith
Chief Tax Counsel
Inland Revenue

Background (material under this heading does not form part of the variation)

Summary of effect

1. An operating lease of an asset has a maximum term of 75% of the asset's estimated useful life before it is treated for tax purposes as a finance lease (with different tax treatment) under the Income Tax Act 2007. Lessors and lessees may have agreed to extend lease terms (or intend to do so) due to the difficulties of transferring possession of the asset during COVID-19 restrictions, or due to the financial impacts of COVID-19. The time period in the definition of "finance lease" has been extended using s 6I of the Tax Administration Act 1994 to allow certain extended leases to continue to be treated as operating leases.

Provisions affected

2. Paragraph (b) of the definition of "finance lease" in s YA 1 of the Income Tax Act 2007.

Application of variation

3. This variation applies to a person who has entered into an operating lease of an asset, but the lease term has been extended beyond 75% of the estimated useful life of the asset, and so in the absence of this variation it would be reclassified as a finance lease for tax purposes, with associated complexity and compliance costs.
4. The variation is subject to the conditions that the lease was entered into before 14 February 2020; that the lease term was not more than 75% of the estimated useful life when the lease was entered into; and that the lessee was prevented or discouraged from returning the lease asset at scheduled maturity, or because the lessee's business has experienced a significant decline in actual or predicted revenue related to COVID-19 meaning the lessee had difficulty in satisfying their existing lease agreement.
5. Customers who may wish to apply this variation should note:
    - A lessor and lessee are not required to adopt the same treatment of the lease asset as both parties can make their own decision about whether they rely on the variation;
    - Customers do not need to take the same approach to all leases they have entered into for the same class of lease asset;
    - The variation applies to leases that are extended between 14 February 2020 and 30 November 2020 and is not limited to leases where the lease term would otherwise have ended during that period.

References

Legislative references

Tax Administration Act 1994: ss 6H and 6I

Income Tax Act 2007: s YA 1, paragraph (b) of the definition of finance lease

FX 20/01: Approval – foreign residential rental property amounts – currency conversion

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

Introduction

2. The Act requires foreign currency amounts to be converted to New Zealand dollars to calculate a taxpayer's New Zealand income tax liability.
3. In some cases, the Act prescribes a currency conversion method or exchange rate source to use, but in most cases it does not. Where the Act does not prescribe a currency conversion method or exchange rate source the default method is the close of trading spot exchange rate on the date the amount is required to be measured or calculated (s YF 1(2)). However, the Commissioner can approve other methods and rates to use (s YF 1(5)) to minimise compliance costs.
4. This Approval approves an annual and a monthly currency conversion method and exchange rate sources that may be used instead of or in conjunction with the spot rate (s YF 1(5)).

Application

5. This Approval only applies to:
   - individuals who own foreign residential rental property, which for the purposes of this Approval include:
     - an individual partner of a partnership who has an interest, as a partner, in a foreign rental property;
     - an individual acting in their capacity as trustee;
   - individuals who are:
     - New Zealand residents; or
     - non-resident trustees to whom s HC 25(2) applies (see Interpretation Statement "IS 18/01: Taxation of Trusts – income tax" *Tax Information Bulletin* Vol 30, No 7 (August 2018): 17); and
   - foreign currency amounts derived from or incurred on residential rental property, including rent, premiums, inducements, early termination payments, rates, insurance, levies, repairs and maintenance costs, acquisition costs, sale proceeds, improvement costs and construction costs.
6. This Approval does not apply where the Act prescribes a currency conversion method or exchange rate source for a particular transaction or arrangement. For example, for financial arrangements, currency conversion methods and exchange rate sources specified in the financial arrangements rules must be used. Note that a foreign loan used to finance a foreign residential rental property may be a financial arrangement.

Currency conversion methods and exchange rate sources approved

7. You may use one of the currency conversion methods or exchange rate sources in this Approval instead of the spot rate (s YF 1(5)).
8. An example showing the use of the methods and exchange rate sources is provided at the end of this Approval.
9. If you want to use a method or exchange rate source not outlined in this Approval, apply to the Commissioner for approval to use that method or source (email **fxconversions@ird.govt.nz**).

Currency conversion methods

10. The Commissioner approves the annual and the monthly currency conversion methods for converting foreign currency amounts related to foreign residential rental properties to New Zealand dollars. These methods are explained below.
11. Use of the annual and monthly methods is subject to the conditions outlined in [24] to [27]. The Commissioner approves the use of these methods in conjunction with amounts converted to New Zealand dollars during the year at the spot rate.

Exchange rate sources

12. The Commissioner approves the following exchange rate sources under s YF 1(5):
    - the foreign exchange rates published by Inland Revenue on its website (**www.ird.govt.nz/managing-my-tax/overseas-currency-conversion-to-nz-dollars**);
    - foreign exchange rates from another reputable source.
13. Use of these exchange rate sources is subject to conditions outlined in [30] to [36].

Currency conversion methods

14. You may use either the annual method or the monthly method for converting foreign currency amounts derived from, or incurred on, your foreign residential rental property.
15. If you choose to use the annual method or monthly method you must use it consistently. However, you may use it in conjunction with amounts converted to New Zealand dollars at the spot rate on the day of the relevant transaction. For example, the annual method or monthly method may be suitable for rental income streams and recurring rental expenditure. The spot rate may be suitable for one-off rental income and expense amounts, such as a gain derived on the sale of a residential rental property, annual tax payments, or the purchase of an item of depreciable property.

Annual method

16. Under the annual method, instead of converting foreign currency amounts on a daily basis, amounts are aggregated and converted at the end of the income year using an annual rate.
17. If using the exchange rates published by Inland Revenue, and the relevant period is a period of 12 months, you can use the rolling 12-month average of mid-month rates provided by Inland Revenue as the annual rate.
18. Otherwise, the annual rate is calculated by adding together the exchange rates for the 15th day of each month in the relevant period (usually 12 months) and then dividing that total by the number of months in the relevant period (usually 12) to arrive at a single annual exchange rate.
19. If you are using an exchange rate source that does not provide exchange rates for the 15th day of each month, then an alternative monthly rate can be used, eg end-of-month or monthly average.

Monthly method

20. Under the monthly method, instead of converting foreign currency amounts on a daily basis, amounts are aggregated and converted at the end of each month using a monthly rate.
21. The monthly rate is based on the exchange rate for the 15th day of the month.
22. If you are using an exchange rate source that does not provide exchange rates for the 15th day of each month, then an alternative monthly rate from the same exchange rate source can be used, eg end-of-month or monthly average.

Amounts converted to New Zealand dollars during the year

23. You may use the annual method or monthly method in conjunction with amounts converted to New Zealand dollars during the income year using spot rates. For example:
    - If you paid foreign tax and converted the amount to New Zealand dollars using the spot rate on the day it was paid, you may use the converted amount;
    - If you purchased an item of depreciable property in foreign currency and converted the foreign currency amount using the spot rate on the day you paid it, you may use the converted amount;
    - If you used a New Zealand credit card to pay a foreign rental expense you may use the New Zealand dollar amount charged to your credit card.

Conditions for use of currency conversion methods

24. You do not need to notify the Commissioner that you will be using the annual method or monthly method to convert your foreign currency amounts to New Zealand dollars.
25. If you choose to use the annual method or monthly method you must use it consistently. For example, if you choose the annual method and use it for residential rental income and recurring residential rental expenditure, you must use it every year for all such income and expenditure. If, in conjunction with the annual method, you use spot rates for residential rental property related tax payments and amounts paid for items of depreciable property, you must use spot rates every year for all such payments and amounts.

26. You must use the method you choose for all:
    - residential rental properties you may purchase in the future;
    - your foreign residential rental properties if you own more than one.
27. However, you can ask the Commissioner for approval to change to a different method (email **fxconversions@ird.govt.nz**).

Exchange rate sources

Approval of exchange rate sources

28. For the purposes of this Approval, the Commissioner has approved the following foreign exchange rate sources under s YF 1(5):
    - Foreign exchange rates published by Inland Revenue on its website (**www.ird.govt.nz/managing-my-tax/overseas-currency-conversion-to-nz-dollars**) which include mid-month and rolling 12-month average rates.
    - Foreign exchange rates from another reputable source. For example, exchange rates published on the Reserve Bank of New Zealand website (**www.rbnz.govt.nz**) or rates obtained from a registered bank. Registered banks are listed on the Reserve Bank of New Zealand website (**www.rbnz.govt.nz/regulation-and-supervision/banks/register**).

Non-trading days

29. Some of the foreign exchange rate sources listed may provide rates for only trading days. If the relevant day of the month is not a trading day, you must use the foreign exchange rate on the preceding trading day.

Conditions

30. Foreign exchange rates from another reputable source must be appropriate given the nature of your rental activity. For example, this will normally mean using retail rather than wholesale rates.
31. Cash and foreign cheque rates must not be used.
32. Where the other reputable source provides exchange rates in the form of buy and sell rates, the average of the corresponding buy and sell rates must be used.
33. You must keep sufficient records in case you later need to verify the exchange rates used. This is especially important where the source of rates is not published or readily available.
34. An exchange rate source must be applied consistently. This means that once you have chosen a source you must, if possible, use that source:
    - for all future conversions, including for properties you may purchase in the future.
    - •or all of your foreign rental properties (if you own more than one).
35. If this is not possible (eg, if the exchange rate source you have been using ceases to be available), you can use a different source without notifying the Commissioner. However, you must keep a record of the change and the reasons for it.
36. In other cases, you can ask the Commissioner for approval to change to a different exchange rate source (email **fxconversions@ird.govt.nz**).

Example

Lucy is a New Zealand tax resident who is not a transitional resident. She has an apartment in France that she rents out.

She has the following income and expenditure (excluding interest on the foreign loan she used to buy the apartment) for the property during the income year in Euro (EUR):

		Annual
Income		
Rent (50 weeks)	€400 a week	€20,000
Expenses		
Rates	€75 a month	€900
Levies and insurance	€300 a month	€3,600
Repairs and maintenance	€500 one-off	€500
Total expenses		€5,000
Net rental income (excluding interest and depreciation)		**€15,000**

LEGISLATION AND DETERMINATIONS

Lucy bought a new fridge for the apartment half-way through the year using her New Zealand credit card. The fridge cost EUR3,000 and NZD5,242.54 was charged to her credit card.

Lucy chooses to use the annual method to convert the rental income and expenses (excluding interest and depreciation). She uses the rates published on Inland Revenue's website, which include rates for converting Euro into New Zealand dollars.

The average of the exchange rates for each month during the income year is NZD0.5714 to EUR1. This is already calculated in the rates published by Inland Revenue in the "Rolling 12-month average" table.

Because she is using an annual method, Lucy can aggregate each income and expenditure type for the year and apply the annual rate to the aggregated amounts:

Income: Lucy has EUR20,000 of rental income for the year:
EUR20,000 divided by 0.5714 = NZD35,001.75.

Expenses: Lucy has EUR5,000 of rental expenses for the year (excluding interest and depreciation):
EUR5,000 divided by 0.5714 = NZD8,750.44.

Lucy also needs to calculate the depreciation deduction on the fridge. Lucy chooses to do this using the actual conversion amount of NZD5,242.54 charged to her credit card instead of the annual method.

Lucy claims a depreciation deduction for the fridge (for 6 months' use) using a diminishing value rate of 25%:

NZD5,242.54 multiplied by 6/12 multiplied by 25% = NZD655.32

Lucy also needs to calculate her interest deduction on the loan she used to buy the apartment. To do this Lucy needs to apply the financial arrangements rules, including the foreign exchange method and source required by those rules. Doing so, Lucy calculates she has an interest deduction of NZD12,513.56. Note that Lucy may also have a non-resident withholding tax obligation on the interest she pays to the lender.

As a result, Lucy's net rental income (NZD) is:

Income	$35,001.75
Expenses (other)	$8,750.44
Depreciation	$655.32
Interest	$12,513.56
Net rental income	**$13,082.43**

Lucy paid EUR2,370 tax in France on income derived from the rental property.

She converts this using the spot rate on the day she paid the tax in France:

EUR2,370 divided by 0.5732 = NZD4,134.68

Lucy may be allowed foreign tax credits for some or all of this amount under the provisions of the DTA with France and subpart LJ.

References

Subject references

Currency conversion
Exchange rate
Foreign currency amount

Legislative references

Income Tax Act 2007, ss YA 1, YF 1

Related rulings/statements

"IS 18/01: Taxation of Trusts – income tax" *Tax Information Bulletin* Vol 30, No 7 (August 2018): 17

"IS 20/06: Income tax – Tax issues arising from ownership of foreign residential rental property" *Tax Information Bulletin* Vol 32, No 7 (August 2020)

"IS 20/07: Income tax – Application of the financial arrangements rules to foreign currency loans used to finance foreign residential rental property" *Tax Information Bulletin* Vol 32, No 7 (August 2020)

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**

BR PUB 20/01: Dividends derived by New Zealand resident investor in a United States limited liability company that is a foreign investment fund where the NZ investor holds foreign investment fund interests of $50,000 or less

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

Taxation laws

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

This Ruling applies to ss CD 1, CD 3, CD 18, CQ 5(1)(d), EX 28, LJ 1(1) and LJ 2(1) and the Double Taxation Relief (United States of America) Order 1983.

Definitions

The following definitions are used in this ruling:

Distribution means a member's share of the US LLC's net profit that is allocated and credited to their capital account and that the Managing Members have resolved to be distributed to a member.

Dividend means a dividend as defined in s CD 3.

Foreign investment fund (FIF) means a foreign investment fund as defined in s EX 28.

Managing Members means the members of the US LLC who are authorised to act on behalf of the US LLC in carrying on the US LLC's business.

Member means a person who has an ownership interest in a US LLC.

New Zealand – United States Double Tax Agreement (NZ–US DTA) means the agreement under the Double Taxation Relief (United States of America) Order 1983.

Non-attributing FIF interest means a FIF where the New Zealand investor's attributing interests in all FIFs is $50,000 or less throughout the year under s CQ 5(1)(d).

Partnership income means a member's distributive share of the US LLC's income that is treated as their partnership income for US federal income tax purposes.

United States limited liability company (US LLC) means a limited liability company formed under state law in the US and classified as a partnership for US federal income tax purposes that is not treated as tax resident in New Zealand.

The arrangement to which this Ruling applies

The Arrangement is as follows:

- A NZ investor is one of the members of a US LLC which has not made an election to be taxed as a corporation.
- The NZ investor is a natural person who is not a transitional resident and is not acting as a trustee other than as a trustee that meets the requirements of section CQ 5(1)(e).
- The US LLC investment is a non-attributing FIF interest for the NZ investor and is not an interest in a controlled foreign company.
- The circumstances in s CQ 5(1)(d)(ii) and (iii) do not apply.
- The US LLC makes a distribution to the NZ investor.
- The US LLC withholds and pays US federal income tax on the NZ investor's partnership income.

- No US federal income tax is paid on the distribution from the US LLC to the NZ investor.
- The US LLC's operating agreement provides that the Managing Members have the power to make distributions to members of the US LLC in their sole discretion.

For the avoidance of doubt, the Arrangement does not include arrangements where subpart BG of the Act applies to void that arrangement.

How the taxation laws apply to the Arrangement

The taxation laws apply to the Arrangement as follows:

- The distribution from the US LLC to the NZ investor will be a dividend under s CD 1.
- The NZ investor is not required to attribute income under s CQ 5(1)(d).
- The NZ investor may claim a deduction for US federal income tax on their US LLC income against any dividend derived from the US LLC under s CD 18.
- The NZ investor is required to take into account the total federal income tax paid on the US LLC interest since acquiring it, any refund and the amounts of such tax previously deducted, from dividends derived under the formula in s CD 18(2).
- The NZ investor cannot claim a New Zealand foreign tax credit (under ss LJ 1(1) and LJ 2(1) or the NZ–US DTA) for US federal income tax paid on partnership income against their New Zealand tax liability on dividends derived from the US LLC.

The period or tax year for which this Ruling applies

This Ruling will apply for the period beginning from the date of issue of this Ruling and ending three years from that date.

This Ruling is signed by me on 26 June 2020.

Susan Price
Group Leader, Tax Counsel Office

BR PUB 20/02: Foreign investment fund income derived by a New Zealand resident investor in a United States limited liability company

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

Taxation laws

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

This Ruling applies to ss CD 1, CD 3, CD 18, CD 36, CQ 4, CQ 5, CX 57B, EX 44, EX 28, EX 51(1), EX 51(6)(b), EX 59(2), LJ 1(1) and LJ 2(1) and the Double Taxation Relief (United States of America) Order 1983.

Definitions

The following definitions are used in this ruling:

Distribution means a member's share of the US LLC's net profit that is allocated and credited to their capital account and that the Managing Members have resolved to be distributed to a member.

Dividend means a dividend as defined in s CD 3.

Foreign investment fund (FIF) means a foreign investment fund as defined in s EX 28.

Managing Members means the members of the US LLC who are authorised to act on behalf of the US LLC in carrying on the US LLC's business.

Member means a person who has an ownership interest in a US LLC.

New Zealand – United States Double Tax Agreement (NZ–US DTA) means the agreement under the Double Taxation Relief (United States of America) Order 1983.

Partnership income means a member's distributive share of the US LLC's income that is treated as their partnership income for US federal income tax purposes.

United States limited liability company (US LLC) means a limited liability company formed under state law in the US and classified as a partnership for US federal income tax purposes that is not treated as tax resident in New Zealand.

The arrangement to which this Ruling applies

The Arrangement is as follows:

- A NZ investor is one of the members of a US LLC that has not elected to be taxed as a corporation and is a FIF.
- Where the NZ investor is a natural person, the cost of their interest in the FIF is greater than $50,000 in a year and they are not a transitional resident.
- The NZ investor adopts one of the following FIF income calculation methods: the fair dividend rate, comparative value, cost method or deemed rate of return.
- The exemptions from holding an attributing interest in a FIF set out in ss EX 31 to EX 43 do not apply.
- The US LLC makes a distribution to the NZ investor.
- The US LLC withholds and pays US federal income tax on the NZ investor's partnership income.
- No US federal income tax is payable on the distribution from the US LLC to the NZ investor.
- The US LLC's operating agreement provides that the Managing Members have the power to make distributions to members of the US LLC in their sole discretion.

For the avoidance of doubt, the Arrangement does not include arrangements where subpart BG of the Act applies to void that arrangement.

How the taxation laws apply to the Arrangement

The taxation laws apply to the Arrangement as follows:

- The NZ investor will be subject to tax on their FIF income as calculated by applying one of the FIF calculation methods (the fair dividend rate, comparative value, cost method or deemed rate of return) under ss CQ 4, CQ 5 and EX 44.
- If the NZ investor uses the comparative value FIF method they may deduct US federal income tax paid in the income year on the partnership income as a cost under s EX 51(6)(b), when calculating their FIF income under the formula in s EX 51(1). It is also a gain in that formula, but this is offset by the US tax payment reducing the closing value in the formula.

BINDING RULINGS

- Any amount derived by the NZ investor from their interest in the FIF (other than FIF income) is excluded income under ss EX 59(2) and CX 57B.
- A distribution paid to the NZ investor by the US LLC is not treated as a dividend for New Zealand tax purposes under s CD 36.
- Section CD 18 does not apply because the distribution from the US LLC to the NZ investor is deemed not to be a dividend under s CD 36.

The NZ investor cannot claim a New Zealand foreign tax credit (under ss LJ 1(1) and LJ 2(1) or the NZ–US DTA) for US federal income tax paid on partnership income against their New Zealand tax liability on FIF income.

The period or tax year for which this Ruling applies

This Ruling will apply for the period beginning from the date of issue of this Ruling and ending three years from that date.

This Ruling is signed by me on 26 June 2020.

Susan Price
Group Leader, Tax Counsel Office

BR PUB 20/03: Attributed foreign investment fund income derived by a New Zealand resident investor in a United States limited liability company

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

Taxation laws

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

This Ruling applies to ss CD 1, CD 3, CD 18, CQ 4, CQ 5, CW 9, EX 44(1)(b), EX 28, EX 50, LK 1(1)(d), OE 1(2) and OE 20 and the Double Taxation Relief (United States of America) Order 1983.

Definitions

The following definitions are used in this ruling:

Distribution means a member's share of the US LLC's net profit that is allocated and credited to their capital account and that the Managing Members have resolved to be distributed to a member.

Dividend means a dividend as defined in s CD 3.

Foreign investment fund (FIF) means a foreign investment fund as defined in s EX 28.

Managing Members means the members of the US LLC who are authorised to act on behalf of the US LLC in carrying on the US LLC's business.

Member means a person who has an ownership interest in a US LLC.

New Zealand – United States Double Tax Agreement (NZ–US DTA) means the agreement under the Double Taxation Relief (United States of America) Order 1983.

Partnership income means a member's distributive share of the US LLC's income that is treated as their partnership income for US federal income tax purposes.

United States limited liability company (US LLC) means a limited liability company formed under state law in the US and classified as a partnership for US federal income tax purposes that is not treated as tax resident in New Zealand.

The arrangement to which this Ruling applies

The Arrangement is as follows:

- A NZ investor is one of the members of a US LLC that has not made an election to be taxed as a corporation and is a FIF.
- Where the NZ investor is a natural person, they are not a transitional resident, and the cost of their interest in the FIF is greater than $50,000 in a year.
- The NZ investor adopts the attributed FIF income method for calculating FIF income.
- The exemptions from holding an attributing interest in a FIF set out in ss EX 31 to EX 43 do not apply.
- The US LLC makes a distribution to the NZ investor.
- The US LLC withholds and pays US federal income tax on the NZ investor's partnership income.
- No US federal income tax is payable on the distribution from the US LLC to the NZ investor.
- The US LLC's operating agreement provides that the Managing Members have the power to make distributions to members of the US LLC in their sole discretion.

For the avoidance of doubt, the Arrangement does not include arrangements where subpart BG of the Act applies to void that arrangement.

How the taxation laws apply to the Arrangement

The taxation laws apply to the Arrangement as follows:

- The NZ investor will be subject to New Zealand tax on the attributed income from their interest in the FIF under ss CQ 4, CQ 5, EX 44(1)(b) and EX 50.
- US federal income tax paid for the NZ investor on their US partnership income is creditable against the NZ investor's FIF attributed income tax liability under s LK 1(1)(d). However, this is only to the extent it does not exceed the New Zealand tax payable on the FIF attributed income and the foreign tax credits do not relate to any foreign tax paid on any active income of the FIF.
- The distribution from the US LLC to the NZ investor will be a dividend under section CD 1.
- Where the NZ investor is a company, any dividends derived by the company from a foreign company are exempt income under s CW 9 unless ss CW 9(2) or (3) apply.
- Where the NZ investor is a natural person, they will be taxed on any dividend derived from the US LLC under s CD 1. This individual NZ investor may deduct any US federal income tax paid on their partnership income from any dividend derived from the US LLC under s CD 18.
- Under the formula in s CD 18(2), the NZ individual investor is required to take into account the total federal income tax paid on the US LLC interest since acquiring it as well as any refund of US tax received and the amounts of such tax previously deducted under the formula.
- An individual NZ investor may choose to be a branch equivalent tax account person under s OE 1(2). If the individual investor has a New Zealand tax liability on their attributed FIF income (after claiming a foreign tax credit), then the individual NZ investor may claim a branch equivalent tax account tax credit (for the New Zealand tax they have paid on their attributed FIF income) against the New Zealand tax liability on the net dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.

The period or tax year for which this Ruling applies

This Ruling will apply for the period beginning from the date of issue of the Ruling and ending three years from that date.

This Ruling is signed by me on 26 June 2020.

Susan Price
Group Leader, Tax Counsel Office

BR PUB 20/04: Controlled foreign corporation income derived by a New Zealand resident investor in a United States limited liability company

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

Taxation laws

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

This Ruling applies to ss CD 1, CD 3, CD 18, CQ 1, CQ 2, CW 9, EX 1, LK 1(1)(d), OE 1(2) and OE 20 and the Double Taxation Relief (United States of America) Order 1983.

Definitions

The following definitions are used in this ruling:

Controlled foreign corporation (CFC) means a controlled foreign corporation as defined in s EX 1.

Distribution means a member's share of the US LLC's net profit that is allocated and credited to their capital account and that the Managing Members have resolved to be distributed to a member.

Dividend means a dividend as defined in s CD 3.

Managing Members means the members of the US LLC who are authorised to act on behalf of the US LLC in carrying on the US LLC's business.

Member means a person who has an ownership interest in a US LLC.

New Zealand – United States Double Tax Agreement (NZ–US DTA) means the agreement under the Double Taxation Relief (United States of America) Order 1983.

Partnership income means a member's distributive share of the US LLC's income that is treated as their partnership income for US federal income tax purposes.

United States limited liability company (US LLC) means a limited liability company formed under state law in the US and classified as a partnership for US federal income tax purposes that is not treated as tax resident in New Zealand.

The arrangement to which this Ruling applies

The Arrangement is as follows:

- A NZ investor is one of the members of a US LLC that has not elected to be taxed as a corporation and their interest is in a CFC.
- Where the NZ investor is a natural person, they are not a transitional resident.
- The US LLC makes a distribution to the NZ investor.
- The US LLC withholds and pays US federal income tax on the NZ investor's share of partnership income.
- No US federal income tax is payable on the distribution from the US LLC.
- The US LLC's operating agreement provides that the Managing Members have the power to make distributions to members of the US LLC in their sole discretion.

For the avoidance of doubt, the Arrangement does not include arrangements where subpart BG of the Act applies to void that arrangement.

How the taxation laws apply to the Arrangement

The taxation laws apply to the Arrangement as follows:

- The NZ investor will be subject New Zealand tax on the attributed income from their interest in the CFC under ss CQ 1 and CQ 2.
- US federal income tax paid for the NZ investor on their US partnership income is creditable against the NZ investor's CFC attributed income tax liability in terms of section LK 1(1)(d). However, this is only to the extent that it does not exceed the New Zealand tax payable on the CFC attributed income and the foreign tax credits do not relate to any foreign tax paid on any active income of the CFC.
- The distribution from the US LLC to the NZ investor who is not a company will be a dividend under s CD 1.
- Where the NZ investor is a company, any dividends derived by the company from a foreign company are exempt under s CW 9 unless ss CW 9(2) or (3) apply.

- Where the NZ investor is a natural person, they will be taxed on any dividend derived from the US LLC under s CD 1. This individual NZ investor may deduct any US federal income tax paid on their partnership income from any dividend derived from the US LLC under s CD 18.
- Under the formula in s CD 18(2), the individual NZ investor is required to take into account the total federal income tax paid on the US LLC interest since acquiring it, as well as any refunds of US tax received and the amounts of such tax previously deducted under the formula.
- An individual NZ investor may choose to be a branch equivalent tax account person under s OE 1(2). If the individual investor has a New Zealand tax liability on their attributed CFC income (after claiming foreign tax credits), then the individual investor may claim a branch equivalent tax account tax credit (for the New Zealand tax they have paid on their attributed FIF income) against the New Zealand tax liability on the net dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.

The period or tax year for which this Ruling applies

This Ruling will apply for the period beginning from the date of issue of the Ruling and ending three years from that date.

This Ruling is signed by me on 26 June 2020.

Susan Price
Group Leader, Tax Counsel Office

BR PUB 20/05: Dividends derived by a New Zealand resident investor in a United States limited liability company that is either a non-attributing active foreign investment fund or a controlled foreign corporation

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

Taxation laws

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

This Ruling applies to ss CD 1, CD 3, CD 18, CW 9, CQ 2(1)(h), CQ 5(1)(c)(xv), EX 1, EX 28, LJ 1(1) and LJ 2(1) and the Double Taxation Relief (United States of America) Order 1983.

Definitions

The following definitions are used in this ruling:

Controlled foreign corporation (CFC) means a controlled foreign corporation as defined in s EX 1.

Distribution means a member's share of the US LLC's net profit that is allocated and credited to their capital account and that the Managing Members have resolved to be distributed to a member.

Dividend means a dividend as defined in s CD 3.

Foreign investment fund (FIF) means a foreign investment fund as defined in s EX 28.

Managing Members means the members of the US LLC who are authorised to act on behalf of the US LLC in carrying on the US LLC's business.

Member means a person who has an ownership interest in a US LLC.

New Zealand – United States Double Tax Agreement (NZ–US DTA) means the agreement under the Double Taxation Relief (United States of America) Order 1983.

Non-attributing active FIF or non-attributing active CFC means a FIF (adopting the attributed foreign investment fund income method and where the NZ investor's interest in the FIF is an exempt non-attributing active FIF interest under s CQ 5(1)(c)(xv)) or a non-attributing active CFC under ss CQ 2(1)(h) and EX 21B.

Partnership income means a member's distributive share of the US LLC's income that is treated as their partnership income for US federal income tax purposes.

United States limited liability company (US LLC) means a limited liability company formed under state law in the US and classified as a partnership for US federal income tax purposes.

The arrangement to which this Ruling applies

The Arrangement is as follows:

- A NZ investor is one of the members of a US LLC that has not elected to be taxed as a corporation and their interest is in a non-attributing active FIF or a non-attributing active CFC.
- Where the NZ investor is a natural person, they are not a transitional resident and the exemptions set out in ss EX 31 to EX 43 do not apply.
- The US LLC makes a distribution to the NZ investor.
- The US LLC withholds and pays US federal income tax on the NZ investor's partnership income.
- No US federal income tax is payable on the distribution from the US LLC.
- The US LLC's operating agreement provides that the Managing Members have the power to make distributions to members of the US LLC in their sole discretion.

For the avoidance of doubt, the Arrangement does not include arrangements where subpart BG of the Act applies to void that arrangement.

How the taxation laws apply to the Arrangement

The taxation laws apply to the Arrangement as follows:

- The NZ investor will not have attributed income for either FIF or CFC purposes under ss CQ 5(1)(c)(xv) or CQ 2(1)(h) respectively.
- The distribution from the US LLC to a NZ investor who is not a company will be a dividend under s CD 1.
- Where the NZ investor is a company, any dividends derived by the company from a foreign company are exempt income under s CW 9 unless ss CW 9(2) or (3) apply.
- Where the NZ investor is a natural person, they will be taxed on any dividend derived from the US LLC under s CD 1. This individual NZ investor can deduct any US federal income tax paid on their partnership income from any dividend derived from the US LLC under s CD 18.
- Under the formula in s CD 18(2),the individual NZ investor is required to take into account the total federal income tax paid on the US LLC interest since acquiring it, as well as any US tax refunds received and the amounts of such tax previously deducted under the formula.
- The NZ investor cannot claim a New Zealand foreign tax credit (under ss LJ 1(1) and LJ 2(1) or the NZ–US DTA) for US federal income tax on partnership income against their New Zealand tax liability on dividend income derived from the US LLC.
- As no FIF or CFC income is attributed for the income year, no branch equivalent tax account credit is available for that year.

The period or tax year for which this Ruling applies

This Ruling will apply for the period beginning from the date of issue of the Ruling and ending three years from that date.

This Ruling is signed by me on 26 June 2020.

Susan Price
Group Leader, Tax Counsel Office

COMMENTARY ON PUBLIC RULINGS BR PUB 20/01 to 20/05

This commentary is not a legally binding statement.

This commentary is intended to help readers understand and apply the conclusions reached in Public Rulings BR Pub 20/01 to 20/05 (the Rulings).

Legislative references are to the Income Tax Act 2007, unless otherwise stated.

Summary

1. A United States limited liability company (US LLC) is a hybrid entity formed in the US that has company and partnership characteristics. A US LLC is a company formed by members to hold business assets and conduct a specific business and provides limited liability to its members. These Rulings are focused on US LLCs that are treated as a partnership, where its members are taxed as partners for US federal income tax purposes.
2. For New Zealand tax purposes, a US LLC is a company and is a separate legal entity from its members. As a US LLC owns the business assets and conducts the specific business, the US LLC is treated as deriving the income that it earns from the conduct of that business for New Zealand tax purposes. Although a US LLC has partnership characteristics, a US LLC does not meet the New Zealand legal requirements for being taxed as a partnership.
3. This commentary explains the circumstances when a foreign tax credit (FTC) or other relief is available to a New Zealand investor in a US LLC for US federal income tax paid by them on their "distributive share"[1] of the US LLC's income. This depends on whether the US LLC is a foreign investment fund (FIF) or a controlled foreign corporation (CFC), and if the US LLC pays a dividend to the New Zealand investor.
4. A New Zealand investor is entitled to claim a New Zealand FTC for US federal income tax paid by them and/or "relief" in terms of s CD 18 or s EX 51 in the three circumstances set out in the Rulings.
5. The first circumstance is where the US LLC is a CFC or a FIF (and the investor adopts the attributable FIF income method) and the New Zealand investor has attributed CFC or FIF income. The New Zealand investor may claim a FTC for any US federal income tax they pay on their distributive share of the US LLC's income against their New Zealand tax liability on attributed CFC or FIF income.
6. The second circumstance is where the New Zealand investor derives a dividend from the US LLC. The New Zealand investor may deduct any US federal income tax they paid on their distributive share of the US LLC's income from that dividend under s CD 18. The New Zealand investor is subject to New Zealand tax on the net dividend amount. Where the New Zealand investor is not subject to New Zealand tax on the dividend from the US LLC, then the relief provided by s CD 18 does not apply because the dividend is not taxable. This will be the case if the New Zealand investor is a company, because foreign dividends derived by a company are exempt income under s CW 9, and where the New Zealand investor adopts one of the following FIF income calculation methods: fair dividend rate, comparative value, cost method or deemed rate of return.
7. The third circumstance is where the New Zealand investor adopts the comparative value method for their FIF income and includes US federal income tax paid on their distributive share of US LLC income as a cost, a gain and as a reduction of the closing value in the formula in s EX 51(1).
8. A New Zealand investor may also be entitled to relief under the New Zealand–US double tax agreement (NZ–US DTA).[2] However, under the specific facts of the arrangements covered by these Rulings, the specific articles in the NZ–US DTA dealing with relief from double taxation do not apply.
9. This commentary is divided into four main areas where we discuss:
   (a) What is a US LLC (from [11]);
   (b) the characteristics of a US LLC that make it a company for New Zealand tax purposes (from [21]);
   (c) why a US LLC is not a partnership for New Zealand tax purposes (from [26]); and
   (d) why a US LLC is treated for New Zealand tax purposes as deriving the income that it earns from the conduct of the US LLC's business (from [29]).
10. Explanatory examples are included from [136]. Abbreviations are listed in the references at the end of the commentary. An Appendix after the references sets out in flow charts how to work out which ruling applies, an overview of the tax treatment of income derived, and then tables of the tax treatment for FIFs and CFCs.

[1] A defined term in the US tax code in relation to partnership taxation (see 26 U.S. Code § 704).

[2] Double Taxation Relief (United States of America) Order 1983.

What is a US LLC?

11. A US LLC is a hybrid legal entity that is a limited liability company but also has characteristics of a partnership.[3] US LLCs are established at the state level under local state law but are similar in structure across the US.

12. US LLCs have four common features:
    (a) The US LLC is a separate legal entity from its members.
    (b) The business of the US LLC is conducted by the US LLC and not its members.
    (c) The assets used for carrying on the business of the US LLC are owned by the US LLC and not by its members.
    (d) The US LLC is liable for the debts incurred as a result of carrying on the US LLC's business. The members have no liability for the liabilities of the US LLC.

13. The operations of a US LLC are generally governed by an operating agreement. Most operating agreements include an explanation of:
    (a) each member's percentage interest in the US LLC represented by their capital account;
    (b) the members' rights and responsibilities;
    (c) how the US LLC will be managed;
    (d) dissolution procedures;
    (e) how profits and losses for financial accounting and tax are to be allocated to each member; and
    (f) rules governing what distribution of a member's share of the US LLC's profits is to be made in a particular year.

14. A US LLC is managed by its members or a manager. A manager may be a group of members (Managing Members) or a third party.

15. Ownership in a US LLC is represented by a membership interest rather than by shares. Therefore, a US LLC's owners are referred to as members rather than shareholders.

16. Generally, profits are allocated to members in proportion to their membership interests as reflected in their capital accounts. However, the operating agreement may specify profit interests for members that are not based on their capital accounts. This mirrors partnerships that may include differential profit-sharing arrangements for members to reflect risk and reward.

17. The distributive share of the US LLC's income on which a member pays US tax is their share of the profits as determined by the operating agreement adjusted, as necessary, to meet the US tax requirements. As such, it may differ from a proportional share of the net accounting income or the specified profit share, as the case maybe.

18. A member's capital account is essentially a measure of a member's equity in a US LLC. It is generally added to by contributions the member has made and by the member's share of profits. The capital account is debited by any share of loss and by any distributions taken by the member.

19. For US federal income tax purposes, a US LLC with multiple members is treated and taxed as a partnership unless an election is made to be taxed as a corporation.[4] Each member of a US LLC pays tax on their distributive share of the US LLC's income, which is reported on the member's individual US federal income tax return.[5] The US LLC files a federal partnership return, and the individual member must include their distributive share in their personal federal income tax return.[6]

20. A US LLC is required to withhold tax from US sourced profits allocated to non-resident members. Different rates apply depending on the income category but commonly 30% is withheld. Since a member has already paid tax on their share of the US LLC's taxable income, the member generally pays no further US tax when the US LLC distributes that income to them. However, further US tax would be payable if, for example, the member was distributed an amount in excess of their capital account. When a member files their US tax return they may receive a refund of US tax, for example, if the NZ-US DTA reduces the applicable rate on the type of income from that withheld by the US LLC.

[3] LLCs with 2 or more members are taxed as partnerships by default unless an election is made to be taxed as a corporation. Single member LLCs are taxed on a flow through basis to that member. When a US LLC is treated as a partnership the members are taxed as partners for federal income tax purposes. The allocation of profits or losses of a US LLC must be made in accordance with the US LLC's limited liability agreement (also known as the US LLC's operating agreement). See, for example, § 18-503 of the 2014 Delaware Code. The allocation of the US LLC's profits to it members and the crediting to their capital account is similar to how profits are allocated and accounted for in a partnership.

[4] *Taxation of Limited Liability Companies* (Publication 3402, Internal Revenue Service, Washington, 2016) provides that a US LLC with at least two members is classified as a partnership for federal income tax purposes.

[5] The US Internal Revenue Code, § 701, states that partners are liable to tax and not the partnership. Each member must file an annual federal income tax return.

[6] As the US LLC is classified as a partnership for federal income tax purposes, the US LLC must file a federal partnership return reporting the taxable income of the partnership computed in terms of § 703 of the Internal Revenue Code (US). However, it is the partners who are liable to income tax and not the partnership: § 701 of the Internal Revenue Code (US).

Characteristics of a US LLC that make it a company for New Zealand tax purposes

21. The word "company" is defined is defined in s YA 1. Company (in part):

    (a) means a body corporate or other entity that has a legal existence separate from that of its members, whether it is incorporated or created in New Zealand or elsewhere:

    (ab) does not include a partnership:

22. In S Watson and L Taylor (eds), *Corporate Law in New Zealand* (online ed, Thomson Reuters, 2019), the authors note the attributes of the modern New Zealand company in the following terms (at [16.1.2]):

    As a species of corporation, the modern company has the following traditional and modern corporate attributes:

    (1) It has perpetual succession. Until dissolved, a company continues to exist and survives the death of its directors and shareholders.

    (2) It owns its property. The assets of a company do not belong to the shareholders. The only interest which they have in the assets of the company is indirectly through the medium of their shares. They have no proprietary rights to the underlying assets. Similarly, creditors of the company are not creditors of the shareholders. The creditors must claim against the company, and it is only if the company is in liquidation and there is some evidence of use of the corporate form to evade obligations that claimants may possibly have recourse against the shareholders.

    (3) As a separate legal person, the company can transact and can sue or be sued in its own name.

    (4) The liability of the shareholders of a limited company is usually limited. Shareholders are only liable for the amount unpaid on their shares.

    (5) As a consequence of limited liability, the capital of the company is locked in creating entity partitioning or strong form entity shielding.

    (6) As the price of incorporation, the company must comply with the formalities of the Act. This requires payment of the registration fee, and the regular filing of documents and accounts with the Registrar of Companies. These are the costs of transacting business in this particular way.

23. A US LLC meets the definition of a company for New Zealand company and tax law purposes for six main reasons:

    (a) A US LLC is a legal entity that comes into existence by the execution of a certificate of formation.[7] It remains in existence until it is dissolved.

    (a) The assets used for carrying on the business of the US LLC belong to the US LLC and not its members.[8]

    (b) The US LLC (and not the members) is liable for the debts incurred as a result of carrying on the US LLC's business. The members have no liability for the liabilities of the US LLC.

    (c) The liability of a member of a US LLC is limited to their capital contributions as defined in the US LLC's operating agreement or, where there is no operating agreement, under state law.[9]

    (d) A US LLC's operating agreement generally specifies how a US LLC will be dissolved and how assets will be allocated to members. In a US LLC, initial capital and retained profits are largely locked in.

    (e) Fees and formalities need to be paid and satisfied to create a US LLC in the US.

24. Alternatively, a US LLC could be an "other entity that has a legal existence separate from that of its members, whether incorporated or created in New Zealand or elsewhere".

25. A US LLC is an entity that has a separate legal existence from its members and is incorporated or created in the US.

Why a US LLC is not a partnership for New Zealand tax purposes

26. Section YA 1 provides that a company does not include a partnership.

27. A "partnership" is defined in s YA 1 to mean a partnership as described in s 4(1) of the Partnership Act 1908. Section 4 of the Partnership Act 1908 defines a partnership as the relationship that "subsists between persons carrying on a business in common with a view to profit".

28. A US LLC is not a partnership for New Zealand tax purposes because it is the US LLC that carries on the business and not the members of the US LLC.

[7] For example, § 18-201 of the LLC Act (Delaware) provides that a company formed under that Act is a separate legal entity until the cancellation of the company's certificate of formation.

[8] For example, § 18-701 of the LLC Act (Delaware) provides that members have no interest in specific property of the LLC.

[9] For example, § 18-502 of the LLC Act (Delaware) states that a member is obligated to an LLC to make their promised cash, property or service contributions.

Why a US LLC is treated for New Zealand tax purposes as deriving the income it earns from the conduct of the US LLC's business

29. A company is a separate legal entity and, for New Zealand tax purposes, is a separate taxpayer from its shareholders. Where a taxpayer owns business assets and carries on a business, then the income from that business is derived by that taxpayer. Section CB 1 states that "an amount that a person derives from a business is income of the person".

30. Although in the context of the Rulings, the US LLC is not a New Zealand taxpayer, the scheme of the Act, as far as business owners are concerned, applies to a US LLC. Accordingly, a US LLC that is a separate legal entity and owns the assets and conducts the business of the US LLC, will be treated as deriving any income it earns from the business activities conducted by it for New Zealand tax purposes (that is, the income will not be treated as derived by the members of the US LLC).

31. Consequently, a New Zealand investor in a US LLC will be subject to New Zealand tax on dividends derived from the US LLC and/or any FIF income or attributed CFC income, where the US LLC is a FIF or a CFC. The New Zealand income tax consequences for a New Zealand investor in a US LLC are discussed next.

How a New Zealand resident investor is taxed on income derived from a US LLC

32. A New Zealand investor in a US LLC will be subject to New Zealand tax on dividends derived from the US LLC and/or any FIF income or attributed CFC income, where the US LLC is a FIF or a CFC.

33. In the following paragraphs, we discuss:
    (a) what a dividend is for New Zealand tax purposes (from [34]);
    (b) when a dividend is derived for New Zealand tax purposes (from [39]);
    (c) what is a dividend in the US LLC context (from [40]);
    (d) the application of the FIF regime to investments in a US LLC (from [49]); and
    (e) the application of the CFC regime to investments in a US LLC (from [73]).

What a dividend is for New Zealand tax purposes

34. Section CD 1 states that a "dividend derived by a person is income of the person". Section CD 3 provides that ss CD 4 to CD 20 define what a dividend is.

35. Section CD 4(1) provides:

> **CD 4 Transfers of company value generally**
>
> *Transfers of company value from company*
>
> (1) A transfer of company value from a company to a person is a dividend if—
>
> (a) the cause of the transfer is a shareholding in the company, as described in section CD 6; and
>
> (b) none of the exclusions in sections CD 22 to CD 37 applies to the transfer.

36. Section CD 5(1) provides:

> **CD 5 What is a transfer of company value?**
>
> *General test*
>
> (1) A **transfer of company value** from a company to a person occurs when—
>
> (a) the company provides money or money's worth to the person; and
>
> (b) if the person provides any money or money's worth to the company under the same arrangement, the market value of what the company provides is more than the market value of what the person provides.

37. Section CD 6(1) expands on s CD 5(1):

> **CD 6 When is a transfer caused by a shareholding relationship?**
>
> *General test*
>
> (1) A transfer of company value from a company to a person (the **recipient**) is caused by a shareholding in the company if—
>
> (a) the recipient at any relevant time—
>
> (i) holds shares in the company; or
>
> (ii) is associated with a shareholder; and
>
> (iii) *[Repealed]*
>
> (b) the company makes the transfer because of that shareholding of the relevant shareholder.

38. In summary, a dividend is a transfer of company value (the provision of money or money's worth) to a person from a company where that transfer in value is because of that person's shareholding (for example, the payment of a dividend to a shareholder in a publicly held company).

When a dividend is derived for New Zealand tax purposes

39. A dividend is not income of a person unless it is also derived by that person for New Zealand tax purposes. The arrangements to which these Rulings apply assume that the New Zealand investor is a cash-basis or an accruals-basis taxpayer. A dividend is derived for both types of taxpayers when the income is credited to the taxpayer's account or in some other way dealt with in their interest or on their behalf, even if it is not treated as derived by them under common law: s BD 3(4).

What a dividend is in the US LLC context

40. A US LLC's operating agreement will specify how the annual net accounting profits or losses of the US LLC are allocated to its members and any profit sharing arrangements that depart from a member's percentage ownership interest.[10] Generally, a proportional share of net profits or losses or the specified profit share are credited or debited to a member's capital account, and any subsequent distribution is debited to the member's capital account.
41. A US LLC's operating agreement will also contain rules for when amounts in a member's capital account will be distributed or held in reserve to meet expected or contingent liabilities.
42. The allocation and crediting to a member's capital account of the member's share of the US LLC's profits is a "dividend" as defined in ss CD 4 and CD 5 for New Zealand tax purposes, as it is a transfer of value (the provision of money or money's worth) by the US LLC to a member and the cause of transfer is the member's "shareholding" in the US LLC.
43. A dividend will be derived by a member when the member has a right to access their share of profits credited to their capital account. This will commonly coincide with the Managing Members of the US LLC (or other person authorised to make that decision) resolving to distribute funds to a member and when the funds are placed outside the control of the Managing Members.
44. The time when funds are placed outside the control of the Managing Members depends on the rules relating to distributions in a particular US LLC's operating agreement. For example, where distributions to a member from the member's capital account are at the sole discretion of the Managing Members (or those authorised to make the decision), then the dividend will be derived by a member at the time the Managing Members resolve to make a distribution to a member and the member can access the funds. In these circumstances, the Managing Members have formally parted with control of the funds, and the member can access those funds as they wish.
45. On the other hand, where a member of a US LLC is able to withdraw their share of the US LLC's profits from their capital account (subject to cash being available) because the US LLC's operating agreement provides for mandatory distributions, then the dividend will be derived for New Zealand tax purposes at the time of crediting to the member's capital account. Examples 1 and 2 explain the practical effects of this difference (the examples start at [136]).
46. The Commissioner's approach is consistent with the High Court decision in *CIR v Albany Food Warehouse* (2009) 24 NZTC 23,532. The court in Albany was required to consider when amounts credited to a shareholder's current account should be treated as paid to them for New Zealand tax purposes. The court concluded the amount was paid if it was placed outside the directors' control as a result of the directors' resolution declaring the dividend and crediting the dividend to the shareholder's current account. The court distinguished the facts of Albany with those in *Alliance Group Ltd v CIR* (1995) 17 NZTC 12,066 where the High Court had concluded that there had not been a payment at the time of crediting to the account of the taxpayer, because the taxpayer did not have the right to draw on the funds in the account.
47. The Rulings assume that distributions from a member's capital account are at the sole discretion of the Managing Members, and that a member will be able to access funds in their capital account only once the Managing Members have resolved to distribute the funds. In such circumstances, a dividend will be derived for New Zealand tax purposes by a member at the time of distribution to that member.
48. The circumstances, and how a dividend derived by a New Zealand investor in a US LLC will be taxed, depends also on whether the US LLC is a FIF or a CFC. The application of the FIF and CFC rules, s CD 18 and New Zealand's FTC rules are discussed next.

[10] Where there is no term in the operating agreement or no operating agreement, then, generally, the US state law on which the US LLC was created will contain a default rule for the allocation of accounting profits or losses to its members. For example, § 18-503 of the 2014 Delaware Code provides that in the absence of a term in the operating agreement, profits or losses should be allocated on the basis of the agreed value of the contributions made by each member.

Application of the FIF regime to investments in a US LLC

49. An investment in a US LLC by a New Zealand investor will be an investment in a FIF (unless it is a CFC) and the FIF rules will apply.

50. Section EX 28 defines a FIF as including a "foreign company". As discussed earlier, s YA 1 defines a "company" to include a body corporate or other entity that has a legal existence separate from its members, whether incorporated or created in New Zealand or elsewhere. Section YA 1 in turn defines a "foreign company" as a company that is not resident in New Zealand. A US LLC is a company for New Zealand tax purposes, and it is assumed that for the purposes of these Rulings the US LLC is not tax resident in New Zealand.

51. A New Zealand investor in a US LLC that is a FIF will be subject to tax on FIF income if they hold an "attributing interest" in the FIF as described in s EX 29 and none of the FIF exemptions in ss EX 31 to EX 43 apply. One category of attributing interest that is relevant to an interest in a US LLC is a direct income interest as described in s EX 30(1):

> **EX 30 Direct income interests in FIFs**
>
> *Categories of direct income interest*
>
> (1) A person has a direct income interest in a foreign company at any time if they hold—
>
> (a) any of the shares in the foreign company:
>
> (b) any of the shareholder decision-making rights for the company:
>
> (c) a right to receive, or to apply, any of the income of the company for the accounting period in which the time falls:
>
> (d) a right to receive, or to apply, any of the value of the net assets of the company, if they are distributed.

52. Shares in a foreign company are a direct income interest: s EX 30(1)(a). A "share" is defined in s YA 1 to "include any interest in the capital of a company". A member's ownership in a US LLC is represented by their membership interest in the LLC (generally in proportion to their capital contributions to the LLC) rather than shares. A member's capital account generally includes initial capital, any additional capital and the allocation of the net accounting profits or losses of the US LLC to its members less distributions made. A member's interest of a US LLC in their capital account is considered an "interest in the capital of the company" and is a "share" for New Zealand tax purposes.

53. A right to receive, or to apply, any of the income of a foreign company for an accounting period in which the time falls is also a direct income interest: s EX 30(1)(c). A US LLC operating agreement may specify a profit interest of each member. In these circumstances, the percentage of a US LLC's profits allocated to a member's capital account is based on the profit interest specified in the operating agreement rather than based on the member's capital interest that is reflected by their capital account balance relative to the total capital of the US LLC. A member's profit interest in a US LLC is considered a "right to receive, or to apply, any of the income of a foreign company for an accounting period in which the time falls" for New Zealand tax purposes.

54. In summary, a member's interest or profit interest in a US LLC can be a direct income interest, so is an attributing interest in a FIF. In these circumstances, a New Zealand investor who is a member of a US LLC will be subject to tax on FIF income (subject to exemptions). It is assumed for the purposes of the Rulings that none of the FIF exemptions in ss EX 31 to EX 43 apply. Similarly, it is assumed that the member is not a transitional resident who is not taxed in New Zealand on certain foreign-sourced income.

55. The FIF rules apply to the following arrangements, as set out in the Rulings.

Where the cost of the New Zealand investor's interests in FIFs is $50,000 or less

56. A natural person and trustees for a limited variety of trusts holding an interest in a FIF will not have FIF income if the cost of the FIF interests they hold does not exceed $50,000 at any time in a year: s CQ 5(1)(d).[11] This assumes the person has not opted to include FIF income despite their FIF interests being less than the threshold. The New Zealand investor will be taxed on only the actual dividends derived from the US LLC (and from any other FIF interests they hold) under s CD 1 and is not required to calculate income under the FIF rules under s CQ 5(1)(d).

57. Section CD 18 applies to provide a deduction for any US federal income tax paid by the New Zealand investor against any dividend derived from the US LLC. Section CD 18(2) includes a formula that requires factoring in any prior deductions claimed for US federal tax since inception of the investment in the US LLC. This is explained in more detail from [106].

58. No FTCs are available to be claimed against the New Zealand tax on any dividend derived from the US LLC because no US tax is paid at source on the distributions.

[11] If the person is a trustee, the requirements of s CQ 5(1)(e) must be met broadly restricting eligibility to testamentary trusts of a person within five years of death, certain court-ordered trusts, and trusts settled by the Accident Compensation Corporation.

59. A New Zealand investor cannot claim a New Zealand FTC (under ss LJ 1(1) and LJ 2(1) or the NZ–US DTA) for US federal income tax on "partnership" income against their New Zealand tax liability on dividend income derived from the US LLC. This is because the US federal income tax paid on the New Zealand investor's distributive share is not paid on the dividend distribution from the US LLC. However, the s CD 18 deduction gives a similar overall effect, albeit as a different way of recognising the US tax paid by the New Zealand investor. For a detailed example, see examples 1 and 2 (the examples start at [136]).

Where the US LLC is a FIF and the FIF income is calculated by applying the fair dividend rate, comparative value, cost method or deemed rate of return

60. Subject to the $50,000 FIF "exemption", a New Zealand investor who has an attributing interest must pay New Zealand tax on their FIF income. The five methods for calculating FIF income are the:[12]
    (a) fair dividend rate (FDR);
    (b) comparative value (CV);
    (c) cost method (CM);
    (d) deemed rate of return (DRR); and
    (e) attributable FIF income method (AFIM).

61. Where a New Zealand investor in a US LLC adopts any of the FDR, CV, CM or DRR FIF income calculation methods, the resulting amount from applying that method is FIF income. Any FIF income calculated under the FDR, CV, CM or DDR calculation methods is a substitute for any actual income derived by a New Zealand investor in the FIF. To avoid double taxation, any actual income derived by a New Zealand investor from a FIF (for example, dividends) who adopts any one of the FDR, CV, CM or DDR calculation methods is excluded income under ss EX 59(2) and CX 57B (that is, it is not assessable income).

62. Additionally, s CD 36 provides that where a person adopts any of the FDR, CV, CM or DRR calculation methods, any actual dividends derived from the FIF are "not a dividend". Section CD 36(1) states:

> **CD 36 Foreign investment fund income**
>
> *Amount not dividend*
>
> (1) An amount paid by a company to a person is not a dividend if, —
>
> (a) at the time the person derives the amount, the person's interest in the company is an attributing interest, or would have been if the company had not been liquidated; and
>
> (b) the person calculates their foreign investment fund (FIF) income or loss in relation to the interest and the period in which the amount is paid under—
>
> (i) the comparative value method:
>
> (ii) the deemed rate of return method:
>
> (iii) the cost method:
>
> (iv) the fair dividend rate method; and
>
> (c) *[Repealed]*
>
> (d) the amount is excluded income under section CX 57B (Amounts derived during periods covered by calculation methods).

63. The effect of s CD 36 excluding an amount derived from a foreign company from being a dividend is that s CD 18 does not apply to a New Zealand investor in a FIF who adopts any of the FDR, CV, CM or DRR calculation methods. Section CD 18 provides relief for New Zealand investors in foreign hybrid entities by allowing a deduction for foreign tax paid against a foreign-sourced dividend derived from the hybrid entity. Section CD 18 cannot apply if there is no dividend (which is the effect of s CD 36).

64. Also, a New Zealand investor cannot claim a New Zealand FTC (under ss LJ 1(1) and LJ 2(1) or the NZ–US DTA) for US federal income tax on their distributive share against their New Zealand tax liability on FIF income. This is because the US federal income tax paid on the New Zealand investor's distributive share is not foreign tax paid on FIF income.

65. For a detailed example, see example 3 (the examples start at [136]).

66. Relief is however available for US federal income tax paid on a NZ investor's distributive share if that investor has adopted CV to calculate their FIF income. Under s EX 51(1) there is a formula for calculating CV income. The formula is increased by "gains" and decreased by "costs". Payment of US tax on behalf of the NZ investor will be a gain as defined in s EX 51(4)(b). "Costs" in the formula are defined in s EX 51(6)(b) as including foreign income tax paid by the person

[12] The Rulings do not consider the branch equivalent and accounting profits method that were available for use for income years beginning on or before 30 June 2011.

BINDING RULINGS

on their FIF income in that income year. The gain is however offset by the fact that US tax withheld is debited to the NZ investor's capital account reducing their "closing value" in the formula which is defined in s EX 51(3). The net result is that the payment of US tax will reduce their FIF income.

Where the US LLC is a FIF and the investor adopts the AFIM

67. In general terms, a New Zealand investor in a FIF may adopt the AFIM for calculating their FIF income, provided the New Zealand investor can:

(a) give the Commissioner (if requested) sufficient information to enable the Commissioner to check the calculations required by s EX 50; and

(b) the FIF is a foreign company; and

(c) the person has a 10% or more income interest in the FIF; and

(d) the foreign company is not a CFC, unless it is a CFC that does not have a readily available market value except one calculated by independent valuation and certain other conditions apply: s EX 46(3)(b).

68. A New Zealand investor will, generally, be subject to tax on any dividends derived from the FIF and any FIF income calculated by applying the AFIM.

69. The New Zealand investor is taxed on their share of the FIF's income under ss CQ 4, CQ 5, EX 44(1)(b) and EX 50.

70. US federal income tax paid by the New Zealand investor on their distributive share of the US LLC's income is creditable against the New Zealand investor's income tax liability on attributed FIF income: s LK 1(1)(d). [Note that this is only to the extent it does not exceed the New Zealand tax payable on the FIF attributed income and the FTCs do not relate to any foreign tax paid on any active income of the FIF.]

71. There are three New Zealand tax consequences where dividends are derived from the US LLC:

(a) Where the New Zealand investor is a company, any dividends derived by a company from a foreign company are exempt income: s CW 9. No FTCs are claimable.

(b) If the New Zealand investor is an individual, a dividend will be income under s CD 1. The New Zealand investor may deduct the US federal income tax paid on their distributive share of the US LLC's income from the dividend derived from the US LLC: s CD 18. The New Zealand investor is subject to New Zealand tax on the net dividend.

(c) An individual New Zealand investor may choose to be a branch equivalent tax account (BETA) person under s OE 1(2). If the individual investor has a net New Zealand tax liability on their attributed FIF income (after claiming FTC), then the individual investor can claim a BETA tax credit (for the New Zealand tax they have paid on their attributed FIF income) against the New Zealand tax liability on the net dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.

72. For a detailed example, see example 4 (the examples start at [136]).

Application of the CFC regime to investments in a US LLC

73. A CFC is defined in the Act as a foreign company controlled by New Zealand residents. A US LLC is a company and will be a "foreign company" provided it is not resident in New Zealand.

74. The US LLC will be "controlled" by New Zealand residents if, for example, a group of five or fewer New Zealand residents has a total control interest of more than 50% in any one of the control interest categories.

75. In general terms, a New Zealand investor will have attributed CFC income in a US LLC (which is a CFC) if they have an income interest in the CFC of 10% or more, the CFC has "net attributable CFC income", and the CFC is not a non-attributing active CFC.

Where the US LLC is a CFC

76. In summary, the New Zealand tax consequences for a US LLC that is a CFC is as follows (which is the same as the tax consequences for a New Zealand investor in a FIF where the investor adopts the AFIM):

(a) The New Zealand investor pays New Zealand tax on their share of attributed CFC income under ss CQ 1 and CQ 2.

(b) Any US federal income tax paid by the New Zealand investor on their distributive share of the US LLC's income is creditable against the New Zealand investor's CFC attributed income tax liability: s LK 1(1)(d). Note that this is only to the extent it does not exceed the New Zealand tax payable on the CFC attributed income and the FTCs do not relate to any foreign tax paid on any active income of the CFC.

(c) A distribution from the US LLC is a dividend for New Zealand tax purposes. The New Zealand tax consequences of the dividend distribution are as follows:

(i) If the investor is an individual, any dividends are assessable to the investor under s CD 1. The New Zealand investor may deduct the US federal income tax paid on their distributive share of the US LLC's income from the dividend derived from the US LLC: s CD 18. The New Zealand investor is subject to New Zealand tax on the net dividend.

(ii) An individual investor can choose to be a BETA person under s OE 1(2).

(iii) Where the New Zealand investor is a company, any dividends derived by the company from a foreign company are exempt income: s CW 9.

77. For a detailed example, see example 5 (the examples start at [136]).

Where the US LLC is a FIF that is a non-attributing active FIF

78. Where a New Zealand investor applies the AFIM, they may also apply the active business exemption. In simple terms, a FIF will satisfy the active business exemption where it has attributable income (income from "passive" sources) that is less than 5% of the FIF's gross income. Where the active exemption applies, the New Zealand investor in the FIF is treated as having an exemption for holding a non-attributing active FIF interest: s CQ 5(1)(c)(xv). In these circumstances, an individual New Zealand investor will be taxed in New Zealand only on any dividend derived from the US LLC. The New Zealand investor may deduct any US federal income tax paid on their distributive share of the US LLC's income from the dividend derived from the US LLC: s CD 18. The New Zealand investor is subject to New Zealand tax on the net dividend.

79. On the other hand, a corporate New Zealand investor is not subject to New Zealand tax, because dividends from a foreign company are exempt income: s CW 9(1).

80. For a detailed example, see example 6 (the examples start at [136]).

Where the US LLC is a non-attributing active CFC

81. Where the US LLC is a non-attributing active CFC, then the tax consequences are the same as described at [78] to [80] for a non-attributing active FIF.

82. There is no attributed income from the CFC under s CQ 2(1)(h).

83. A New Zealand investor is subject to New Zealand tax only on dividends derived from the US LLC as follows:

(a) If the investor is an individual, any dividends are assessable to the individual investor under s CD 1. The New Zealand investor may deduct the US federal income tax paid on their distributive share of the US LLC's income from the dividend derived from the US LLC: s CD 18. The New Zealand investor is subject to New Zealand tax on the net dividend.

(b) Where the investor is a company, any dividends derived by the company from a foreign company are exempt income: s CW 9. No FTCs are claimable.

84. For a detailed example, see example 6 (the examples start at [136]).

What foreign taxes a New Zealand investor pays in respect of a US LLC are creditable against the investor's FIF income, CFC income or dividend tax liability

85. Several FTC provisions may apply to a New Zealand investor in a US LLC in this context:

(a) Sections LJ 1(1) and LJ 2(1) set out the general rule for claiming an FTC where foreign tax has been paid on a New Zealand investor's foreign-sourced income, which is also subject to New Zealand tax.

(b) Section LJ 2(6) and (7) sets out a special rule for claiming an FTC where the New Zealand investor adopts one of the FDR, CV, CM or DRR FIF income calculation methods. Foreign tax paid on actual foreign-sourced dividends may be claimed against the New Zealand tax liability on the FIF income derived by a New Zealand investor.

(c) Section LK 1 sets out the FTC rules that apply to a New Zealand resident investor with attributed income from a CFC or a FIF where they have adopted the AFIM.

Sections LJ 1(1) and LJ 2(1) – general rule

86. Sections LJ 1(1) and LJ 2(1) provide the general rule that a person is entitled to a tax credit for foreign tax paid against their New Zealand income tax liability in relation to foreign-sourced income. They also set out how to calculate the New Zealand tax applicable on that foreign-sourced income.

87. Section LJ 1(1) and (2)(a) provide:

LJ 1 What this subpart does

When tax credits allowed

(1) **This subpart provides the rules for dividing assessable income from foreign-sourced amounts into segments and allows a tax credit for foreign income tax paid in relation to a segment of that income**.

Limited application of rules

(2) The rules in this subpart apply only when—

(a) a person resident in New Zealand derives assessable income that is sourced from outside New Zealand; [Emphasis added]

88. Section LJ 2(1) to (3) provide:

LJ 2 Tax credits for foreign income tax

Amount of credit

(1) **A person described in section LJ 1(2)(a) has a tax credit for a tax year for an amount of foreign income tax paid on a segment of foreign-sourced income**, determined as if the segment were the net income of the person for the tax year. The amount of the New Zealand tax payable is calculated under section LJ 5.

Limitation on amount of credit

(2) The amount of the person's credit in subsection (1) must not be more than the amount of New Zealand tax payable by the person in relation to the segment calculated under section LJ 5(2), modified as necessary under section LJ 5(4).

Amount adjusted

(3) The amount of the person's credit in subsection (1) may be reduced or increased if either section LJ 6 or LJ 7 applies. [Emphasis added]

89. A "segment of foreign source income" is defined in s LJ 4 as "a person has a s**egment of foreign-sourced income** equal to an amount of assessable income derived from 1 foreign country that comes from 1 source or is of 1 nature". For example, a dividend derived by a New Zealand investor from a US LLC would be a segment of foreign-sourced income because it is an amount of assessable income derived from one foreign country (the US) that comes from one source (the US LLC) or is of one nature (a dividend).

90. A New Zealand investor may claim a FTC against New Zealand tax payable on that foreign-sourced dividend, for an "amount of foreign tax paid" on that segment of foreign-sourced income. The FTC claimable by the New Zealand investor cannot exceed the New Zealand tax payable in relation to the foreign-sourced dividend: s LJ 2(2).

91. Section LJ 2(1) and (2) do not apply to the arrangements in the Rulings for two reasons.

92. The first reason is that no US tax is paid on the dividend distributions (segment of foreign-sourced income) that are taxed in New Zealand.

93. The second reason is that a New Zealand investor pays US federal income tax on their distributive share of the US LLC's income. However, this cannot be claimed as a FTC against the New Zealand investor's dividend income derived from the US LLC, because that foreign tax is not paid "on" that segment of foreign-sourced income under s LJ 2(1). In other words, a dividend derived by a New Zealand investor from a US LLC and the New Zealand investor's distributive share of the US LLC's income are different segments of foreign-sourced income. A New Zealand investor cannot claim a FTC for foreign tax paid on a segment of foreign-sourced income (US federal income tax on a New Zealand investor's distributive share of the US LLC's income) against the New Zealand tax liability on a different segment of foreign source income (a dividend derived from the US LLC).

94. The application of the NZ–US DTA is considered at [118] to [125]. Article 22 of the NZ–US DTA operates in essentially the same way as ss LJ 1(1) and LJ 2(1) by permitting a FTC for foreign tax paid but only on the same income, for example, a foreign-sourced dividend taxed in New Zealand and in the US.

Section LJ 2(6) and (7) – special rule

95. Section LJ 2(6) and (7) provides:

When subsection (7) applies

(6) Subsection (7) applies to a person who derives an amount from an attributing interest in a FIF when the amount is treated as not being income under section EX 59(2) (Codes: comparative value method, deemed rate of return method, fair dividend rate method, and cost method).

Tax credit

(7) The person has a tax credit under this subpart for foreign income tax paid on or withheld in relation to the amount. The calculation of the maximum amount of the tax credit is made under section LJ 5(2), modified so that the item segment in the formula is the amount of FIF income from the attributing interest that the person derives in the period referred to in section EX 59(2).

96. Any FIF income calculated under the FDR, CV, CM or DDR calculation methods is a substitute for actual income derived by a New Zealand investor in the FIF. To avoid double taxation, any actual income derived from a FIF by a New Zealand investor who adopts any one of the FDR, CV, CM or DDR calculation methods is excluded income under ss EX 59(2) and CX 57B (that is, it is not assessable income).

97. Notwithstanding this "exemption", the special rule in s LJ 2(6) and (7) provides that any foreign tax paid on such actual income derived by a New Zealand investor may be credited against a New Zealand investor's New Zealand tax liability on FIF income calculated under the FDR, CV, CM or DDR calculation methods. For example, if a New Zealand investor derives a foreign-sourced amount that has been subject to foreign tax, then the New Zealand investor can claim a FTC under s LJ 2(6) and (7) against their New Zealand tax lability on FIF income calculated under the FDR, CV, CM or DDR calculation methods (but not exceeding the New Zealand tax applicable on the FIF income: s LJ 2(2)).

98. However, ss LJ 2(6) and (7) do not apply to the distributions from the US LLC in the context of the arrangements in the Rulings, as no US tax is paid on the distributions from the US LLC that are dividends for New Zealand tax purposes. Sections LJ 2(6) and (7) also do not apply in relation to any US federal income tax paid by a New Zealand investor in a US LLC on their distributive share of the US LLC's income. That "partnership" income is not income derived by the New Zealand investor for New Zealand tax purposes.

Subpart LK – CFC and FIF income

99. Where a person has attributed CFC income or applies the AFIM to their FIF interest, then that person is entitled to a FTC against their New Zealand CFC or FIF income tax liability as determined in s LK 1.

100. Section LK 1(1) provides:

LK 1 Tax credits relating to attributed CFC income

Amount of credit

(1) A person who has an amount of attributed CFC income for an income year has a tax credit for the tax year corresponding to the income year equal to the following amounts paid or payable in relation to the attributed CFC income:

(a) an amount of income tax paid by the CFC from which the income is derived:

(b) an amount of tax withheld and paid on behalf of the CFC from which the income is derived:

(c) the amount of foreign income tax paid by the CFC from which the income is derived:

(d) the amount of foreign income tax paid by the person in relation to the CFC from which the income is derived:

(e) the amount of foreign tax paid, under legislation of another country or territory that is equivalent of the international tax rules, by a foreign company in relation to income derived by the CFC.

101. Section LK 1(1) sets out the rules for claiming FTCs for foreign tax paid or payable by a CFC or a FIF (applying the AFIM), against a person's New Zealand tax liability on attributed FIF or CFC income. Subpart LK is designed to accommodate timing mismatches that routinely can occur between different jurisdictions. Consequently, tax paid or payable in the US that relates to the CFC or FIF attributed income derived by a person in New Zealand can be claimed as a credit, even if not paid in the relevant income year in New Zealand. Section 93C of the Tax Administration Act 1994 assists if the amount of the credit cannot be determined before a return is filed. The Commissioner must amend an assessment upon request to reflect a credit if the request is made within four years from the end of the relevant income year. It is not however possible to claim a FTC under s LK (1) if it relates to attributed income in a different income year. Any FTC claimed is limited to an amount that offsets the tax payable in New Zealand on the attributed FIF or CFC income derived as if it were standalone income in the relevant year. Any surplus is not refundable but may be carried forward to a subsequent income year under s LK 4 provided the loss carry forward requirements of s LK 5 are met.

102. In ordinary circumstances, the tax is paid by the CFC or FIF (that is, s LK 1(1)(c) applies). Section LK 1(1)(d) is an important exception, as it deals with the scenario where a CFC or a FIF does not itself pay the CFC's or FIF's foreign income tax, but another person does (for example, a New Zealand investor in the CFC or FIF that is a foreign hybrid entity). Section LK 1(1)(d) was introduced to enable a New Zealand investor in a CFC or a FIF (which is a hybrid company or partnership) to claim a FTC for any foreign income tax paid (for example, US federal income tax paid by the New Zealand investor on their distributive share of the US LLC's income) against their New Zealand tax lability on attributed CFC or FIF income.

103. The effect of s LK 1(1)(d) is that a New Zealand investor in a hybrid entity (for example, a US LLC) that is a CFC or a FIF (applying the AFIM) may claim a FTC for foreign tax that they pay in relation to that CFC or FIF. This is in the same way as a New Zealand investor in a foreign company that is not a hybrid entity and that is also a CFC or a FIF (applying the AFIM) may claim a tax credit for foreign tax that the CFC or FIF pays. The tax credit is available for attributed CFC and FIF (applying the AFIM) income only.

How s CD 18 applies to investments in a US LLC

104. Section CD 18 is a special provision that addresses the possible over-taxation of foreign-sourced dividend income derived by a New Zealand investor from a foreign hybrid entity. This arises where a shareholder pays the foreign tax of the hybrid entity that, in ordinary circumstances, the hybrid entity would pay, and this reduces the amount available for distribution as a dividend by the entity. Section CD 18 is directed at hybrid entities such as a US LLC, which is a company for New Zealand tax purposes but taxed as a partnership for US tax purposes. Section CD 18(1) and (2) provides:

> **CD 18 Dividend reduced if foreign tax paid on company's income**
>
> *When this section applies*
>
> (1) This section applies when a person—
>
> (a) derives a dividend from a company that is a foreign company; and
>
> (b) has a liability under the laws of a country or territory outside New Zealand for income tax on income of the company corresponding to the liability that the person would have under the laws of New Zealand for income tax on income of the company if the company were a partnership in which the person were a partner; and
>
> (c) pays the income tax; and
>
> (d) provides to the Commissioner upon request, in the time allowed by the Commissioner, sufficient information to satisfy the Commissioner as to the amount of income tax paid.
>
> *Amount of dividend reduced*
>
> (2) The amount of the dividend is reduced by the greater of zero and the amount calculated using the formula—
>
> total tax paid − earlier reductions.
>
> *Definition of items in formula*
>
> (3) In the formula,—
>
> (a) total tax paid is the total amount of income tax on income of the company that the person has paid in the country or territory by the time that the person derives the dividend:
>
> (b) earlier reductions is the total amount of reductions under this section that, by the time that the person derives the dividend, have affected other dividends derived by the person from the company.

105. Section CD 18 works to eliminate the over-taxation of dividends derived by a New Zealand investor in a hybrid entity such as a US LLC, so that the New Zealand investor is treated for New Zealand tax purposes as deriving the same amount of dividend income as a New Zealand investor in an ordinary (that is, non-hybrid) foreign company. This outcome is achieved by allowing a New Zealand investor in a foreign hybrid entity to deduct from a dividend derived from the foreign hybrid entity, any foreign tax that the New Zealand investor pays (for example, as a "partner") on the foreign hybrid's income. Note that the provision only permits a deduction for tax actually paid by the time the dividend is derived. Unlike subpart LK it does not extend to "tax paid or payable" to cover any timing mismatches between New Zealand and the foreign jurisdiction. Also, any refunds of foreign tax received must reduce the amount available as a deduction under s CD 18. A New Zealand investor in a US LLC may receive a refund as a result of filing their required personal tax return in the US. The treatment of a tax refund is illustrated in example 1 from [137].

106. There is a requirement under the formula in s CD 18(2) to reconcile the foreign tax deducted from all dividends derived since inception of the investment in the company. This ensures that only amounts of foreign tax paid not already claimed as a deduction are available to reduce the dividends from the company that are taxed in New Zealand each year.

107. The application of s CD 18 is best illustrated by an example that assumes the following:

(a) An individual New Zealand investor's interest in a US LLC cost less than $50,000 in a year (that is, the New Zealand investor is required to pay tax on only dividends derived from the FIF).

(b) The New Zealand investor's distributive share of the US LLC's income for federal income tax purposes is $1,000. The US LLC makes a $700 distribution in that year.

(c) The US imposes 30% ($300) federal income tax on the New Zealand investor's distributive share of the US LLC's income. The US LLC withholds the tax and pays it on behalf of the New Zealand investor.

(d) The US LLC made a distribution to the New Zealand investor in the prior year when the interest in the LLC was first acquired and US federal income tax was paid on that and then used to reduce the dividend derived in the prior year for New Zealand tax purposes.

(e) All amounts are expressed in New Zealand dollars.

108. For New Zealand tax purposes, the $700 distribution and US withholding tax payment of $300 will both be a dividend. If the full $1,000 is taxed in New Zealand there would be over-taxation of that dividend from the New Zealand investor's perspective compared with a dividend paid by an ordinary non-hybrid foreign company, because no recognition is given to the $300 US federal income tax the New Zealand investor paid.

109. In the case of an ordinary non-hybrid foreign company, the US company would pay the US tax of $300 and the dividend paid to the New Zealand investor would be $700 (after US company tax is paid). Section CD 18 achieves its objective by allowing the New Zealand investor to deduct the foreign tax that they pay on their distributive share of "partnership" income from any dividend that they derive from a foreign hybrid (the US LLC in this case).

110. In this example, the New Zealand investor is taxed on $700 ($1,000 – $300), which is the same amount they would have been taxed on if the US LLC had been an ordinary US company and paid the $300 company tax on its own income, then distributed the remaining (after tax) amount of $700. The $300 reduction was made after taking into account the total US federal tax paid on the US LLC since inception under the formula in s CD 18(2) and the amount of that tax used to reduce the dividend derived in the prior year.

111. In the context of the Rulings, albeit using a different mechanism than allowing FTCs, s CD 18 provides relief from the cross-jurisdictional taxation of dividends derived by New Zealand individual investors from a foreign hybrid entity. Section CD 18 deductions are available to investors in a US LLC that is a FIF or a CFC, except where the New Zealand investor is:

(a) taxed on FIF income calculated applying one of the FDR, CV, CM or DRR FIF income calculation methods, because the dividend is "exempt" in this case; or

(b) a company, because dividends derived by a New Zealand company from a foreign company are exempt income.

How subpart OE (BETA) applies to individual investors in a US LLC

112. Section OE 1(2) provides that a natural person resident in New Zealand may choose to be a BETA person and maintain a BETA. These rules apply to an investment in a CFC and a FIF (where the New Zealand investor adopts the AFIM: s OE 5).

113. The purpose of a BETA is to enable an individual investor who has a net New Zealand tax liability (after FTCs have been applied) on their attributed CFC or FIF income to credit that amount to their BETA and to use this credit to satisfy any New Zealand tax liability payable on dividends derived from the FIF or CFC.

114. A BETA allows an individual investor to claim a tax credit (for tax that they pay on attributed CFC or FIF income) against their tax liability on dividend income, in a similar way to an investor in a New Zealand resident company claims an imputation credit for underlying tax paid by the company. In both cases, the purpose of the credit is to avoid economic double taxation on the dividend derived by an individual investor.

115. A New Zealand resident company cannot maintain a BETA. However, as dividends derived from a foreign company by a New Zealand resident company are exempt income, economic double taxation does not arise.

116. The BETA tax credit is calculated by applying the formula set out in s OE 19. For example, a New Zealand investor may have attributed CFC or FIF income of $10,000 and foreign tax paid relating to that income of $3,000 (30%). Assume that the New Zealand investor's New Zealand tax liability is $3,300 (33%). The New Zealand investor can satisfy the New Zealand income tax liability by applying FTCs of $3,000 and paying the net tax liability of $300. The net tax paid of $300 can be credited to a person's BETA and applied against any subsequent New Zealand tax liability on any dividend derived from the CFC or FIF.

117. The New Zealand investor's right to use BETA tax credits to satisfy an income tax liability and the criteria that need to be satisfied for their use are set out in s OE 20.

How the NZ–US DTA applies to an investment in a US LLC

118. A DTA can extend the circumstances where a country agrees to double taxation relief beyond their respective domestic tax laws. Two articles in the NZ–US DTA deal with relief from double taxation (arts 1(6) and 22) and may be relevant to the Rulings.

Article 22 of the NZ–US DTA provides relief where the same income is taxed to the same person in two tax jurisdictions

119. Article 22 of the NZ–US DTA provides (in part):

> In the case of New Zealand, double taxation shall be avoided as follows:
>
> In accordance with, and subject to any provisions of, the law of New Zealand which may from time to time be in force and which relate to the allowance of a credit against New Zealand tax for tax paid in a country outside New Zealand (which shall not affect the general principle hereof), **United States tax paid under the law of the United States** and consistently with this Convention, whether directly or by deduction, **in respect of income derived by a resident of New Zealand arising in the United States** (excluding in the case of a dividend, tax paid in respect of the profits out of which the dividend is paid) **shall be allowed as a credit against New Zealand tax payable in respect of that income**; except that such credit shall not exceed the amount of the tax that would be paid to the United States if the resident were not a United States citizen or a United States company. However, where a company which is a resident of New Zealand beneficially owns at least 10 percent of the paid-up share capital of a United States company any dividend derived by the first-mentioned company from the United States company (being dividends which, in accordance with the taxation law of New Zealand in existence at the date of signature of the Convention would be exempt from New Zealand tax) shall be exempt from New Zealand tax.
>
> …
>
> For the purpose of allowing relief from double taxation pursuant to this Article, income shall be deemed to arise as follows:
>
> (a) income derived by a resident of the United States which may be taxed in New Zealand in accordance with this Convention shall be deemed to arise in New Zealand;
>
> (b) **income derived by a resident of New Zealand which may be taxed in the United States** in accordance with the Convention (other than income taxed by the United States solely because the beneficial owner is a citizen of the United States or a United States company) **shall be deemed to arise in the United States**;
>
> (c) For purposes of paragraph 3, income beneficially owned by a resident of New Zealand who is a citizen of the United States or a United States company shall be deemed to arise in New Zealand to the extent necessary to give effect to the provisions of this paragraph. [Emphasis added]

120. Article 22 applies to US tax paid in respect of the same income derived by a New Zealand resident and arising in the US. That is, art 22 provides relief where the same income is taxed to the same person in two tax jurisdictions.

121. In the US LLC context, an amount allocated and credited to a member's capital account and distributed to a New Zealand investor is a dividend derived for New Zealand tax purposes and will "arise" in the US. However, in terms of the arrangements in the Rulings, no US tax is paid at source on this dividend distribution, so no FTC is claimable. The New Zealand investor has paid US federal income tax on their distributive share of the US LLC's US taxable income on a partnership basis, but that is not US tax paid on the distribution to the New Zealand investor (which is a dividend for New Zealand tax purposes).

Article 1(6) of the NZ–US DTA applies to a foreign investment by a New Zealand or US resident through a transparent entity

122. Article 1(6) of the NZ–US DTA deals with transparent entities, stating:

> An item of income, profit or gain derived through an entity that is fiscally transparent under the laws of either Contracting State shall be considered to be derived by a resident of a State to the extent that the item is treated for purposes of the taxation law of such Contracting State as the income, profit or gain of a resident.

123. Article 1(6) applies to a foreign investment by a New Zealand or US resident through a transparent entity. Income derived through a transparent entity is taxed to a New Zealand or US resident only where that entity is treated as transparent for the purposes of New Zealand and US tax law respectively; for example, a New Zealand investor in a partnership established in the US that is also a partnership for New Zealand tax purposes. The US partnership is a partnership for New Zealand tax purposes and is transparent for New Zealand tax purposes: s HG 2. In these circumstances, the New Zealand partner is taxed directly on their share of the partnership income.

124. Article 1(6) does not apply to a New Zealand investor in a US LLC.[13] A New Zealand investor derives partnership income under US federal income tax law (which satisfies the first part of art 1(6)), but that partnership income is not treated for the purposes of the taxation law of New Zealand as the income, profit or gain of the New Zealand investor in the US LLC (so the second part of art 1(6) is not satisfied). This is because the US LLC is a company and not a transparent entity for New Zealand tax purposes.

125. Article 1(6) does not apply to the facts of the Rulings.

[13] This is confirmed in the (US) *Department of the Treasury Technical Explanation of the Protocol Between the United States of America and New Zealand…signed at Wellington on July 23, 1982*, in an example at the last paragraph of pg 4.

Overseas authority

126. The United Kingdom (UK) Supreme Court in *Anson v Commissioners for HMRC* [2015] UKSC 44 considered a dispute where the facts were materially similar to those in the Rulings. The court reached a different conclusion from the Commissioner's conclusion in the Rulings. This raises the question, to what extent, if any, does *Anson* apply in New Zealand?

127. *Anson* involved a UK investor in a Delaware LLC. The dispute revolved around whether Anson was entitled to a FTC for US tax he paid on his distributive share of the US LLC's income against UK tax paid on distributions from the US LLC. Her Majesty's Revenue and Customs argued that no FTC was available because the distribution that was taxed in the UK was not the same income as Anson's distributive share of the US LLC's income on which the US tax had been paid. On the other hand, Anson argued that the income taxed in the US and UK was the same income, so he was entitled to a FTC for US tax paid.

128. The UK Supreme Court confirmed on appeal the reasoning of the First Tier Tribunal in *Mr Swift v Commissioners for HMRC* [2010] UKFTT 88 (TC). The UK Supreme Court concluded that the taxpayer was entitled to the profits of the US LLC as they arose because of the effect of § 18-503 of the LLC Act (2014 Delaware Code) and art IV of the US LLC's operating agreement, so the US LLC should be categorised as a transparent entity (and the members taxed directly on the profits of the US LLC). In its judgment, the tribunal concluded that the characteristics of the US LLC were such that it was more akin to a partnership than a company. The Delaware LLC Act (§ 18-503) required that the profits and losses of an LLC were to be allocated to members in accordance with the US LLC's operating agreement. Article IV of the US LLC's operating agreement provided the US LLC's gross income and expenses were to be credited and debited to a member's capital account respectively.

129. Where the Commissioner is required to classify a foreign entity, such as a US LLC, for domestic tax law purposes, the approach adopted is to identify the key legal characteristics of the foreign entity and then to classify that entity by reference to New Zealand domestic tax law definitions (e.g. company or partnership). This approach is discussed in L Collins, *Dicey and Morris on the Conflict of Laws* (13th ed, Sweet & Maxwell, London, 2000) at [2.009]:

> If the forum has to characterise a rule or institution of foreign law, it should inquire how the corresponding or most closely analogous rule or institution of its own law is characterised, and apply that characterisation to the foreign institution or rule.

130. Applying this approach, the potentially relevant corresponding or analogous entities for New Zealand tax purposes are a company, look-through company and partnership.

131. It is the Commissioner's view that a US LLC is a company for New Zealand tax purposes for the reasons discussed at [21] to [25]. Additionally, the New Zealand legislative scheme provides that if a company owns and conducts a business, then the company (not the shareholders or members of the company) will be treated as deriving the income that it earns from the conduct of that business: s CB 1. In this context, a US LLC is a company and a separate legal entity. The US LLC owns the business assets, and the US LLC (not its members) conducts the business of the US LLC. Accordingly, under the scheme of the Act, the US LLC (not its members) is treated as deriving the income that it earns.

132. The Commissioner does not consider that a US LLC is a look-through company or a partnership for New Zealand tax purposes. A look-through company is a special type of company for New Zealand tax purposes, where, provided certain criteria are met, the shareholders are taxed on a look-through basis akin to a partnership – like a US LLC. One of the criteria for being a look-through company is that the company is resident in New Zealand. An underlying assumption in the Rulings is that the US LLC is a foreign company (that is, it is not resident in New Zealand). Therefore, US LLCs that these Rulings apply to are not look-through companies for New Zealand tax purposes.

133. A US LLC is not a partnership for New Zealand partnership law or tax purposes because the essential criterion for being a partnership is absent; that is, no relationship exists between persons (members in this context) carrying on business for profit (because it is the US LLC that carries on the business). A New Zealand investor in a US LLC would be taxed directly on the profits of a US LLC only if it were a partnership for New Zealand tax purposes.

134. The Commissioner does not consider that Anson applies in New Zealand. In Anson, an important element of the UK court's reasoning was that the US LLC was akin to a Scottish partnership so should be treated as a transparent entity and its UK members taxed on a look-through basis. The Commissioner considers that the UK approach to categorising a foreign hybrid entity as transparent or opaque, based on whether that entity has features more akin to a partnership or company does not apply in New Zealand. In New Zealand, entities and transactions are characterised according to their legal form and not what transaction or entities they most closely resemble: *Mills v Dowdall* [1983] NZLR 154 (CA) at 159. The Commissioner considers that a US LLC is a company because the legal characteristics of the US LLC meet the New Zealand tax definition of company and not merely because it more closely resembles a company than a partnership.

135. Section CD 18 is also an important feature of the scheme of the Act dealing with foreign hybrid entities. Section CD 18 deals explicitly with company–partnership foreign hybrids (US LLCs in this context) and the over-taxation of foreign source dividend income derived from a foreign hybrid entity. Section CD 18 permits a New Zealand investor in a foreign hybrid entity to deduct the foreign tax that they have paid from the dividend they derive from the foreign company. Section CD 18 is premised on the foreign hybrid entity (US LLC in this context) being a company that derives its own income and pays a dividend to its shareholder (even though it is taxed as a partnership in the foreign tax jurisdiction).

Examples

136. The following six examples have common features:

(a) A New Zealand investor (natural person or company) invests in a US LLC and is not the sole shareholder.

(b) The US LLC is a company for New Zealand tax purposes.

(c) The US LLC owns the assets of the business, and the business is conducted by the US LLC and not by its members.

(d) The US LLC is treated as a partnership in the US, has not made an election to be taxed as a corporation and the New Zealand investor is subject to US federal income tax on their distributive share of the US LLC's income.

(e) The New Zealand investor's US federal income tax liability is withheld by the US LLC and paid on behalf of its New Zealand investors.

(f) The New Zealand investor is required to and does file a US tax return including their distributive share of the US LLC income and tax withheld on their behalf by the US LLC.

(g) The payment of US federal income tax by the US LLC withheld on behalf of its New Zealand investors is treated in the US LLC's accounts as a distribution to the investors (that is, as a debit to the member's capital account).

(h) The payment by the US LLC of the member's US federal income tax on their behalf is a distribution and a dividend for New Zealand tax purposes.

(i) The Managing Members of the US LLC have the power to make distributions in their sole discretion. (Note that this feature does not apply to example 1.)

(j) No US tax is paid on distributions from the US LLC, which are dividends for New Zealand tax purposes.

(k) The US federal income tax rate is assumed to be 30%.

(l) Where the New Zealand investor is a natural person, it is assumed they have a marginal tax rate of 33%, are not a transitional resident, and have not opted into the FIF rules where the FIF interests they hold are $50,000 or less.

(m) All amounts are expressed in New Zealand dollars.

Example 1: Individual New Zealand investor's investment in a US LLC is under the $50,000 FIF threshold and distributions to members are mandatory

Circumstances

137. An individual New Zealand investor invests in a US LLC that is a FIF for New Zealand tax purposes. The cost of the individual investor's attributing interest in FIFs does not exceed $50,000 throughout the year.

138. The New Zealand investor can withdraw amounts from their capital account, representing their share of the US LLC's annual net accounting profits on request, subject to cash being available.

139. The New Zealand investor's share of the US LLC's net accounting profit is $1,100, as determined by the US LLC's operating agreement. This share is credited to the New Zealand investor's capital account in year 1. The New Zealand investor can withdraw this amount from their capital account as they wish.

140. The New Zealand investor's distributive share of the US LLC's income for US federal income tax purposes is $1,000, and the US federal income tax liability on that income is $300 (30%). The distributive share is the NZ investor's proportional share of net accounting profits adjusted as required to meet US tax requirements.

141. The New Zealand investor's US federal tax liability is withheld by the US LLC on behalf of the investor and is treated as a distribution by the US LLC (debited against the New Zealand investor's capital account) in year 1.

142. The US LLC subsequently distributes $700 to the New Zealand investor in year 2. The New Zealand Investor also receives a US tax refund of $50 in year 2 after filing their US tax return for year 1.

143. Years 1 and 2 correspond to two different New Zealand income tax years – New Zealand income tax years 1 and 2.

New Zealand tax consequences

144. The New Zealand investor will be taxed on the $1,100 dividend (the amount credited to their capital account and able to be withdrawn by the New Zealand investor) derived from the US LLC under s CD 1. The investor is not required to calculate income under the FIF rules under s CQ 5(1)(d). The New Zealand investor will be subject to tax on this dividend in New Zealand in income tax year 1, being the year in which the amount was credited to the New Zealand investor's capital account and available for the New Zealand investor to withdraw.

145. The total distribution of $1,000 (the $700 distribution and the $300 US federal income tax paid by the US LLC on behalf of the New Zealand investor) is not subject to New Zealand tax. This is because the dividend has already been subject to New Zealand tax in New Zealand income tax year 1. The dividend cannot be taxed twice due to s BD 3(6).

146. Section CD 18 applies to provide a deduction for the US federal income tax paid by the New Zealand investor ($300) in year 1. In other words, the New Zealand investor's income is $1,100 (the dividend) less $300 (the US tax paid by the New Zealand investor). The New Zealand investor pays New Zealand income tax (at 33%) on the net dividend of $800 ($264). Both the US tax of $300 taken as a reduction of dividend income and the $50 tax refund received in year 2 decrease the amount of US tax that can be claimed in future under s CD 18 from year 2 onwards.

147. The New Zealand investor cannot claim a New Zealand FTC (under ss LJ 1(1) and LJ 2(1) or the New Zealand–US DTA) for US federal income tax on the distributive share of the US LLC's income against their New Zealand tax liability on dividend income derived from the US LLC. This is because the US federal income tax paid on the New Zealand investor's distributive share is not US tax paid on a dividend derived from the US LLC.

Example 2: Individual New Zealand investor's investment in a US LLC is under the $50,000 FIF threshold and distributions are not mandatory

Circumstances

148. An individual New Zealand investor invests in a US LLC that is a FIF for New Zealand tax purposes. The cost of the individual investor's attributing interest in FIFs does not exceed $50,000 throughout the year.

149. The New Zealand investor's distributive share of the US LLC's income for US federal income tax purposes is $1,000, and the US federal income tax liability on that income is $300 (30%).

150. The New Zealand investor's US federal tax liability is withheld and paid by the US LLC on behalf of the investor and is treated as a distribution by the US LLC (debited against the New Zealand investor's capital account).

151. The US LLC subsequently distributes $700 to the New Zealand investor.

New Zealand tax consequences

152. The New Zealand investor will be taxed on only the actual dividends (the $700 distribution and $300 US federal income tax paid by US LLC on behalf of the New Zealand investor) derived from the US LLC under s CD 1. The investor is not required to calculate income under the FIF rules under s CQ 5(1)(d).

153. Section CD 18 applies to provide a deduction for the US federal income tax paid by the New Zealand investor ($300). In other words, the New Zealand investor's income is $1,000 (the dividend) less $300 (the US tax paid by the New Zealand investor). The New Zealand investor pays New Zealand income tax (at 33%) on the net dividend of $700 ($231).

154. The New Zealand investor cannot claim a New Zealand FTC (under ss LJ 1(1) and LJ 2(1) or the New Zealand–US DTA) for US federal income tax paid on the distributive share against their New Zealand tax liability on the $1,000 distribution treated as dividend income derived from the US LLC. This is because the US federal income tax paid on the New Zealand investor's US LLC distributive share is not paid on the dividend distribution from the US LLC.

Example 3: Individual New Zealand investor in a US LLC adopts one of four FIF income calculation methods

Circumstances

155. A New Zealand individual investor invests in a US LLC that is a FIF for New Zealand tax purposes. The cost of their interest is $60,000.

156. The New Zealand investor adopts one of the four income calculation methods: FDR, CV, CM or DRR.

157. The New Zealand investor's FIF income from the US LLC adopting FDR is $2,000.

158. The New Zealand investor's distributive share of the US LLC's income for federal income tax purposes is $2,800, and the US federal income tax liability on that income is $840 (30%).

159. The New Zealand investor's US federal tax liability is withheld and paid by the US LLC on behalf of the investor and is treated as a distribution by the US LLC (debited against the New Zealand investor's capital account).

160. The US LLC subsequently distributes $1,900 to the New Zealand investor.

New Zealand tax consequences

161. The New Zealand investor will be taxed in New Zealand on their FIF income as calculated by applying one of the four FIF income calculation methods. In this example, the FIF (FDR) income is $2,000 and New Zealand tax (at 33%) is $660.

162. The total distribution of $2,740 (the $1,900 distribution and the $840 US federal income tax paid by the US LLC on behalf of the New Zealand investor) paid to the New Zealand investor by the US LLC is excluded income under ss EX 59(2) and CX 57B. It is also explicitly excluded from being a dividend for New Zealand tax purposes under s CD 36. Section CD 36 deems a distribution not to be a dividend where a person adopts any of the four methods (FDR, CV, CM or DRR) of calculating FIF income.

163. Section CD 18, which provides relief from the over-taxation of dividend distributions from foreign hybrid entities, does not apply because the distribution is deemed not to be a dividend under s CD 36.

164. A New Zealand investor cannot claim a New Zealand FTC (under ss LJ 1(1) and LJ 2(1) or the New Zealand–US DTA) for US federal income tax on their distributive share against their New Zealand tax liability on FIF income. This is because the US federal income tax paid on the New Zealand investor's distributive share is not foreign tax paid on FIF income.

165. A New Zealand investor who adopts CV for their FIF income will treat the payment of the $840 of US tax on its behalf as a cost, a gain and as a reduction of the closing value under the formula in s EX 51(1) when calculating their FIF income.

Example 4: New Zealand investor adopts the AFIM for calculating FIF income

Circumstances

166. A New Zealand investor (a company or individual) invests in a US LLC that is a FIF for New Zealand tax purposes. The New Zealand investor adopts the AFIM for calculating FIF income.

167. The New Zealand investor's FIF attributed income is $2,000 in their first year of holding the US LLC.

168. The New Zealand investor's distributive share of the US LLC's income for federal income tax purposes is $2,100, and the US federal income tax liability on that income in the first year is $630 (30%).

169. The New Zealand investor's US federal tax liability ($630) is withheld and paid by the US LLC on behalf of the investor and is treated as a distribution by the US LLC (debited against the New Zealand investor's capital account).

170. The US LLC subsequently distributes $1,400 to the New Zealand investor.

New Zealand tax consequences

171. The New Zealand investor is subject to New Zealand income tax on FIF income and on any dividends (if they are an individual) derived from the US LLC.

172. The New Zealand investor is taxed on their share of the FIF's income ($2,000), and New Zealand tax is $660 (33% if an individual) or $560 (28% if a company) under ss CQ 4, CQ 5, EX 44(1)(b) and EX 50.

173. The US federal income tax paid ($630) by the New Zealand investor on their share of the US LLC's income is creditable against the New Zealand investor's FIF attributed income tax liability: s LK 1(1)(d). Note that this is only to the extent it does not exceed the New Zealand tax payable on the FIF attributed income and the FTCs do not relate to any foreign tax paid on any active income of the FIF. The individual New Zealand investor's net New Zealand tax liability is $660 less $630 (the FTC for US tax paid on their distributive share of the US LLC's profit), which equals $30 net New Zealand tax payable. For a company investor, no further NZ tax is payable as the FTC exceeds the NZ tax amount ($560-$630).

174. The total distribution of $2,030 (the $1400 distribution and the $630 US federal income tax paid by US LLC on behalf of the New Zealand investor) from the US LLC is a dividend for New Zealand tax purposes and taxable income of the individual New Zealand investor. The New Zealand tax consequences of the dividend distribution are as follows:

  (a) Where the New Zealand investor is a company any dividends derived by a company from a foreign company are exempt income: s CW 9. No FTCs are claimable.

  (b) If the New Zealand investor is an individual, then the $2,030 dividend is income under s CD 1. The New Zealand investor may deduct the US federal income tax paid on their share of the US LLC's income ($630) from the dividend derived from the US LLC ($2,030): s CD 18. The New Zealand investor is subject to New Zealand tax on the net dividend (that is, net of foreign tax paid by them in the US, which is $1400).

(c) An individual New Zealand investor may choose to be a BETA person under s OE 1(2). If the individual investor has a net New Zealand tax liability on their attributed FIF income (after claiming an FTC), then the individual investor may claim a BETA tax credit (for the New Zealand tax they have paid on their attributed FIF income) against the New Zealand tax liability on the net dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.

(d) The net New Zealand tax liability after FTCs is $30 (the FIF income tax liability of $660 ($2,000 FIF income x 33% tax rate) less FTC $630 = $30). The $30 may be used as a BETA tax credit to satisfy any New Zealand tax liability on dividends derived from the FIF.

Example 5: Investment in a US LLC that is a CFC

Circumstances

175. A New Zealand investor (company or individual) invests in a US LLC that is a CFC.

176. The New Zealand investor's CFC income is $2,000 in the first year of their investment.

177. The New Zealand investor's distributive share of the US LLC's income in that same year is also $1,900. The US federal income tax liability on that income is $570 (30%).

178. The New Zealand investor's US federal tax liability ($570) is withheld and paid by the US LLC on behalf of the investor and is treated as a distribution by the US LLC (debited against the New Zealand investor's capital account).

179. The US LLC subsequently distributes $1,300 to the New Zealand investor.

New Zealand tax consequences

180. The New Zealand investor is subject to New Zealand income tax on CFC income and any dividends derived from the US LLC.

181. The New Zealand investor is taxed on their share of the CFC's income that is, $2,000 and New Zealand tax (at 33%) for the individual is $660 and (at 28%) for the company is $560 under ss CQ 1 and CQ 2.

182. The US federal income tax paid ($570) by the New Zealand investor on their share of the US LLC's income in the same year they acquired the investment is creditable against the New Zealand investor's CFC attributed income tax liability: s LK 1(1)(d). Note that this is only to the extent it does not exceed the New Zealand tax payable on the CFC attributed income and the FTCs do not relate to any foreign tax paid on any active income of the CFC. The individual New Zealand investor's net New Zealand tax liability is $660 less $570 (the FTC for US tax paid on their share of the US LLC's profit), which equals $90 net New Zealand tax payable. Where the New Zealand investor is a company there is no further New Zealand tax liability as the FTC of $570 exceeds the NZ tax liability of $560.

183. The total distribution of $1,870 (the $1,300 distribution and the $570 US federal income tax paid by US LLC on behalf of the New Zealand investor) from the US LLC is a dividend for New Zealand tax purposes and taxable income of the individual New Zealand investor. The New Zealand tax consequences of the dividend distribution are as follows:

(a) Where the New Zealand investor is a company, any dividends derived by a company from a foreign company are exempt income: s CW 9. No FTCs are claimable.

(b) If the New Zealand investor is an individual, then the $1,870 dividend is income in terms of s CD 1. The New Zealand investor may deduct the US federal income tax paid on their distributive share of the US LLC's income ($570) from the dividend derived from the US LLC ($1,870): s CD 18. The New Zealand investor is subject to New Zealand tax on the net dividend (that is, net of foreign tax paid by them in the US, which is $1,300).

(c) An individual New Zealand investor can choose to be a BETA person under s OE 1(2). If the individual investor has a net New Zealand tax liability on their attributed FIF income (after claiming FTC), then the individual investor may claim a BETA tax credit (for the New Zealand tax they have paid on their attributed CFC income) against the New Zealand tax liability on the net dividend (net of foreign tax paid through the application of s CD 18) under s OE 20.

(d) There is a net New Zealand tax liability after FTCs of $90 (the FIF income tax liability of $660 ($2,000 FIF income x 33% tax rate) – FTC $570 = $90). The $90 may be used as a BETA tax credit to satisfy any New Zealand tax liability on dividends derived from the CFC.

Example 6: Investment in a US LLC that is a non-attributing active FIF or a non-attributing active CFC

Circumstances

184. A New Zealand investor (company or individual) invests in a US LLC that is a non-attributing active FIF or CFC.

185. The New Zealand investor's distributive share of the US LLC's income for federal income tax purposes in their first year of investment is $1,000, and the US federal income tax liability on that income is $300 (30%).

BINDING RULINGS

186. The New Zealand investor's US federal tax liability ($300) is withheld and paid by the US LLC on behalf of the investor and is treated as a distribution by the US LLC (debited against the New Zealand investor's capital account).

187. The US LLC subsequently distributes $700 to the New Zealand investor.

New Zealand tax consequences

188. There is no attributed income for either CFC or FIF purposes under s CQ 2(1)(h) or s CQ 5(1)(c)(xv) respectively.

189. The individual New Zealand investor is subject to New Zealand tax on only the $1,000 dividend distribution.

190. The New Zealand tax consequences of the dividend distribution are as follows:

(a) Where the investor is a company, any dividends derived by a company from a foreign company are exempt income: s CW 9. No FTCs are claimable.

(b) If the investor is an individual, then the $1,000 dividend (the $700 distribution and the $300 US federal income tax paid by US LLC on behalf of the New Zealand investor) is assessable to the individual investor under s CD 1. The New Zealand investor may deduct the US federal income tax paid on their share of the US LLC's income ($300) from the dividend derived from the US LLC ($1,000): s CD 18. The individual New Zealand investor is subject to New Zealand tax on the net dividend (that is, net of foreign tax paid by them in the US, which is $700).

(c) An individual New Zealand investor can choose to be a BETA person under s OE 1(2). However, as there is no FIF or CFC attributed income for the income year, no BETA credit is available for that year.

References

Legislative references

2014 Delaware Code, § 18-503

Double Taxation Relief (United States of America) Order 1983, arts 1, 22

Income Tax Act 2007, ss BD 3, CB 1, CD 1, CD 3 to CD 20, CD 36, CQ 1, CQ 2, CQ 4, CQ 5, CW 9, CX 57B, EX 28 to EX 37, EX 37B, EX 38 to EX 42, EX 42B, EX 43, EX 44, EX 46, EX 50, EX 51, EX 59, HG 2, LJ 1, LJ 2, LJ 4, LK 1, LK 4, K 5 subpart OE, YA 1 ("company", "foreign company", "partnership", "share")

Internal Revenue Code (US), §§ 701, 703

Limited Liability Company Act (Delaware), §§ 18-201, 18-502, 18-701

Partnership Act 1908, s 4

Tax Administration Act 1994, s 93C

Case references

Alliance Group Ltd v CIR (1995) 17 NZTC 12,066 (HC)

Anson v Commissioners for HMRC [2015] UKSC 44

CIR v Albany Food Warehouse (2009) 24 NZTC 23,532 (HC)

Mills v Dowdall [1983] NZLR 154 (CA)

Mr Swift v Commissioners for HMRC [2010] UKFTT 88 (TC)

Other references

Collins, L, *Dicey and Morris on the Conflict of Laws* (13th ed, Sweet & Maxwell, London, 2000)

IRS, *Taxation of Limited Liability Companies* (Publication 3402, Internal Revenue Service, Washington, 2016)

(US) *Department of the Treasury Technical Explanation of the Protocol Between the United States of America and New Zealand...signed at Wellington on July 23, 1982*

Watson, S, and L Taylor (eds), *Corporate Law in New Zealand* (online ed, Thomson Reuters, 2019)

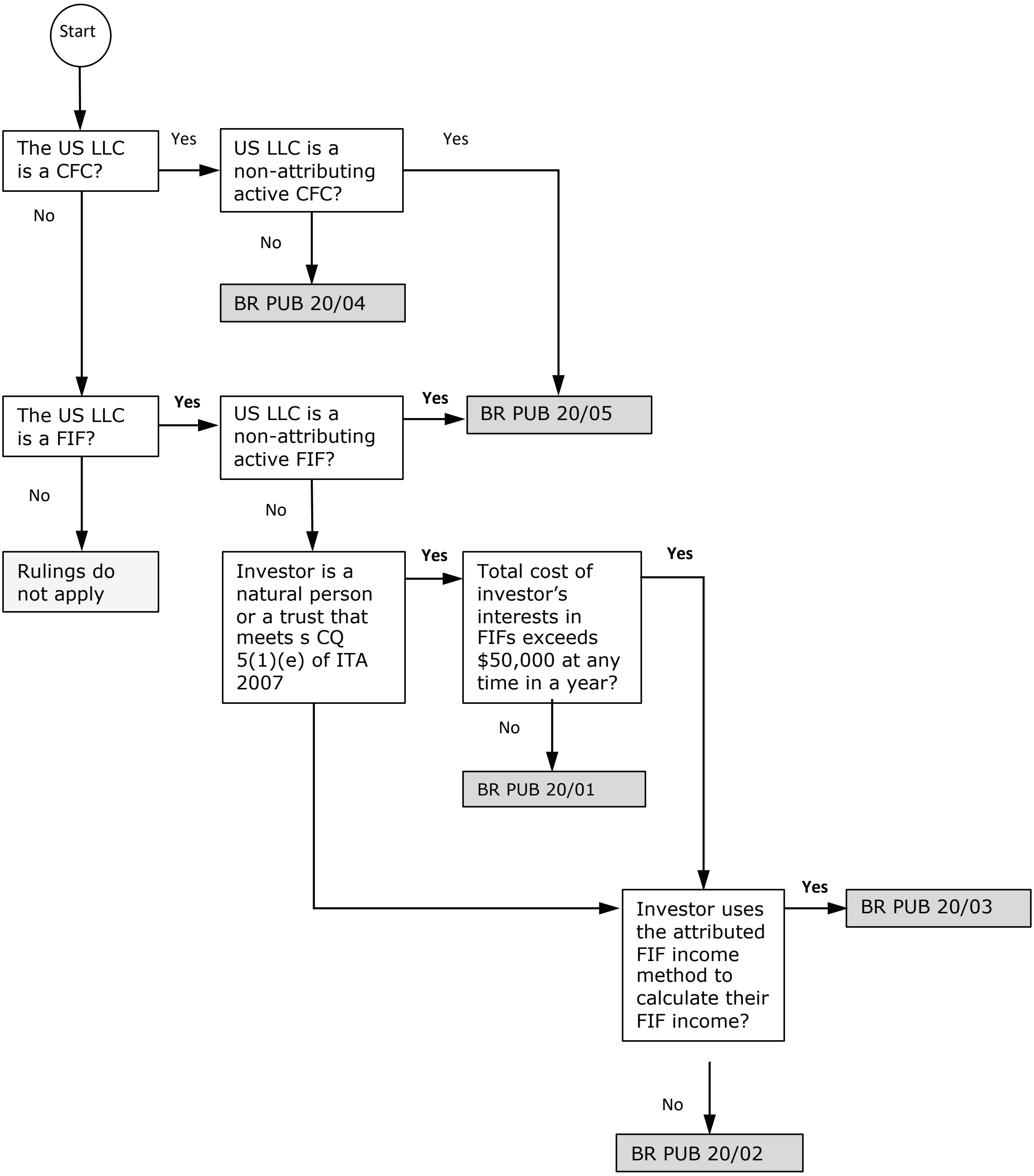
Abbreviations

AFIM method	attributable foreign investment fund income
art, arts	article, articles
BETA	branch equivalent tax account
CFC	controlled foreign corporation
CM	cost method
CV	comparative value
DRR	deemed rate of return
FDR	fair dividend rate
FIF	foreign investment fund
FTC	foreign tax credit
NZ–US DTA	Double Taxation Relief (United States of America) Order 1983
s, ss	section, sections
US LLC	United States limited liability company

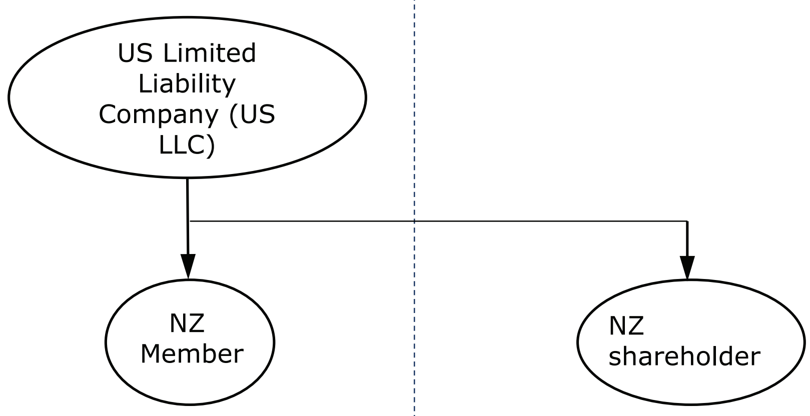
BINDING RULINGS

Appendix

Which Ruling applies to my situation?



Tax treatment of income derived by a NZ investor from a US LLC

Jurisdiction	United States	New Zealand	
			
Income tax treatment of US LLC	**Partnership if more than one member unless elects to be a corporation**	**Foreign company**	
Taxation of income derived by investor	**Distributive share** LLC withholds US federal income tax from NZ member's distributive share of US LLC's income.	**FIF/CFC income** Investor pays income tax on FIF income or CFC income derived from LLC.	**Distributions** Non-corporate investors pay income tax on distributions from US LLC that are dividends.
Double taxation relief available in New Zealand		Foreign tax credit for US federal income tax paid available for FIF-AFIM and attributing CFCs. Relief for US federal income tax paid available when comparative value method used for FIF income.	Deduction under s CD 18 for US tax paid where dividend taxable BETA credit available for non-corporate investors who derive FIF-AFIM or CFC attributed income

FIF table

US LLC is a FIF: Tax treatment of income amounts and double taxation relief for income derived by NZ investor			**Non-attributing active FIF**	**FIF income – AFIM method**	**FIF income – other methods**	**No FIF income - Total FIF interests < $50K**
Natural persons and trusts that meet s CQ 5(1)(e) of ITA	**Share of LLC profits**	**FIF income?**	N	Y	Y	N/A
		FTC?	N	Y – capped at NZ tax	N	N/A
	Distribution	**Income tax treatment**	Taxable Dividend	Taxable Dividend	Not a dividend	Taxable dividend
		CD 18 deduction?	Y	Y	N	y
		BETA?	N/A	Y	N	N/A
Other persons who are not corporates	**Share of LLC profits**	**FIF income?**	N	Y	Y	N/A
		FTC?	N	Y – capped at NZ tax	N	N/A
	Distribution	**Income tax treatment**	Taxable dividend	Taxable dividend	Not a dividend	N/A
		CD 18 deduction?	y	y	N	N/A
		BETA?	N/A	y	N	N/A
Companies	**Share of LLC profits**	**FIF income?**	N	y	y	N/A
		FTC?	N	Y-capped at NZ tax	N	N/A
	Distribution	**Income tax treatment**	Exempt dividend	Exempt dividend	Not a dividend	N/A
		CD 18 deduction?	N/A	N/A	N/A	N/A
		BETA?	N/A	N/A	N/A	N/A

CFC table

US LLC is a CFC: Tax treatment of income amounts and double taxation relief for income derived by NZ investor			**Non-attributing active CFC**	**Attributing CFC**
Persons other than corporates	**Share of LLC profits**	**CFC income?**	N	Y
		FTC?	N	Y – capped at NZ tax
	Distribution	**Income tax treatment**	Taxable dividend	Taxable dividend
		CD 18 deduction?	Y	Y
		BETA?	N/A	Y
Company	**Share of LLC profits**	**CFC income?**	N	Y
		FTC?	N	Y – capped at NZ tax
	Distribution	**Income tax treatment**	Exempt income	Exempt income
		CD 18 deduction?	N/A	N/A
		BETA?	N/A	N/A

BR PUB 20/06: Income Tax and Goods and Services tax – Director's liability and the COVID 19 "safe harbour" in schedule 12 to the Companies Act 1993

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

Taxation laws

This Ruling applies in respect of s HD 15(1) of the Income Tax Act 2007 (ITA) and s 61 of the Goods and Services Tax Act 1985 (GSTA).

The arrangement to which this Ruling applies

The Arrangement is the directors of a company, in good faith, agreeing to the company carrying on business, including trading and incurring obligations, in reliance on the COVID 19 "safe harbour" in schedule 12 to the Companies Act 1993 (CA) during the "safe harbour period".

The safe harbour period started on 3 April 2020 and ends on the close of 30 September 2020 (or later, if the period is extended by regulation).

During the safe harbour period, a decision by the directors of a company to keep on trading, as well as decisions to take on new obligations, will not result in a breach of the duties in ss 135 and 136 of the CA. Sections 135 and 136 of the CA provide that a director of a company must not:

- agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors;
- cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or
- agree to the company incurring an obligation, unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

A company's directors can rely on the safe harbour only where:

- the directors consider in good faith that the company is facing or is likely to face significant liquidity problems in the next six months because of the impact of COVID 19 on the company or its creditors;
- the company was able to pay its debts as they fell due on 31 December 2019 (or the company was incorporated on or after 1 January 2020 but before 3 April 2020); and
- the directors consider in good faith that it is more likely than not that the company will be able to pay its debts as they fall due within 18 months (for example, because trading conditions are likely to improve or the company is likely to able to reach an accommodation with its creditors).

For the avoidance of doubt, this Arrangement does not include any particular "arrangement" entered into in relation to a company that, on its own terms, would ordinarily be subject to s HD 15 of the ITA or s 61 of the GSTA, even if it is entered into during the safe harbour period.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Reliance on the safe harbour by a director, and the company continuing to trade or carry on business or incur new obligations on commercial, ordinary business terms, will not, in and of itself, result in the application of s HD 15 of the ITA or s 61 of the GSTA.
- For the avoidance of doubt, s HD 15 of the ITA or s 61 of the GSTA would still apply to any particular "arrangement" entered into in relation to a company that, on its own terms, would ordinarily be subject to those provisions, even if it is entered into during the safe harbour period.

The period or tax year for which this Ruling applies

This Ruling will apply for the period beginning on 3 April 2020 and ending on 30 September 2020.

This Ruling is signed by me on 10 July 2020.

Howard Davis
Group Leader, Tax Counsel Office

COMMENTARY ON PUBLIC RULING BR PUB 20/06

This commentary is not a legally binding statement. This commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 20/06 (the Ruling).

Relevant legislative provisions are reproduced in the Appendix to this commentary.

Summary

1. Under the recently enacted COVID 19 safe harbour in schedule 12 to the Companies Act 1993 (CA), during the safe harbour period certain decisions by the directors of a company, will not result in a breach of the duties in ss 135 and 136 of the CA where:
   - the directors consider in good faith that the company is facing or is likely to face significant liquidity problems in the next six months because of the impact of the COVID 19 pandemic on the company or its creditors;
   - the company was able to pay its debts as they fell due on 31 December 2019 (or the company was incorporated on or after 1 January 2020 but before 3 April 2020); and
   - the directors consider in good faith that it is more likely than not that the company will be able to pay its debts as they fall due within 18 months (for example, because trading conditions are likely to improve or the company is likely to able to reach an accommodation with its creditors).
2. It is possible (if not likely) that despite the existence of the safe harbour, some companies will still face insolvency and be unable to pay their tax liabilities. This raises the issue of whether a director of a company who has made decisions in reliance of the safe harbour, or a relevant shareholder of the company, could be liable for the tax liability.
3. Section HD 15 of the Income Tax Act 2007 (ITA) (asset stripping of companies) permits income tax owing by a company to be recovered from the company's directors and shareholders where an arrangement has been entered into that has an effect that the company cannot meet a tax liability. Section 61 of the Goods and Services Tax Act 1985 (GSTA) provides that s HD 15 applies as if "income tax" and "tax" read "goods and services tax".
4. Section HD 15(1) of the ITA sets out when the section applies, with the liability for a director or shareholder (as agent) being provided for in s HD 15(3) to (5) and (7). This Ruling and commentary are limited to whether the requirements of s HD 15(1) of the ITA, and therefore s 61 of the GSTA, are met in the context of the safe harbour and do not provide guidance on the application of those sections more generally.
5. For s HD 15 of the ITA to apply, four requirements must be satisfied:
   - An arrangement is entered into in relation to a company.
   - The arrangement has an effect that the company cannot meet a tax liability (either an existing liability or one that arises later).
   - It is reasonable to conclude that a purpose of the arrangement is that the company cannot meet or will not be able meet a tax liability.
   - It is reasonable to conclude that if a director of the company at the time of the arrangement had made reasonable inquiries, they could have anticipated that the tax liability would, or would likely, be required to be met.
6. Determining the effect and intended purpose of an arrangement is highly fact specific.
7. Considering the four requirements, for s HD 15 of the ITA or s 61 of the GSTA to apply, it is necessary for the arrangement to:
   - involve the depletion of the assets of a company; and
   - be designed to have the effect that the company cannot pay a tax obligation.
8. The Commissioner's view is that s HD 15 of the ITA or s 61 of the GSTA will not apply to a company that is unable to pay a tax obligation where:
   - the directors of a company facing significant liquidity problems because of the effects of COVID 19 and the resulting economic climate, decide in good faith to rely on the safe harbour and continue carrying on business; or
   - as a result of the directors' decision to rely on the safe harbour, the company continues carrying on business and trading or incurs new obligations on ordinary commercial business terms (for example, bank loans or sales at credit).
9. However, s HD 15 of the ITA and s 61 of the GSTA will still, in the Commissioner's view, apply to any arrangement that would ordinarily be subject to the provision, notwithstanding that the arrangement was entered into during the safe harbour period following a company directors' decision to rely on the safe harbour.

10. Examples illustrating the general approach to the application of s HD 15 of the ITA and s 61 of the GSTA in the context of the COVID 19 safe harbour can be found later in this commentary.

Background – safe harbour

11. The COVID 19 Response (Further Management Measures) Legislation Bill Government Act 2020 introduced, among other things, a "safe harbour" in relation to two directors' duties in the CA. The Companies Office describes this safe harbour on its website:[1]

> The introduction of a 'safe harbour' from sections 135 and 136 of the Companies Act 1993 will provide relief to company directors facing insolvency as a result of COVID 19.
>
> The 'safe harbour' provisions – which have been backdated to April 3, when the proposals were first announced – aim to ease the pressure on directors who may otherwise feel the need to wind up their business, perhaps prematurely, owing to the current climate.

12. The relevant directors' duties in ss 135 and 136 of the CA provide as follows:

> **135 Reckless trading**
>
> A director of a company must not—
>
> (a) agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or
>
> (b) cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.
>
> **136 Duty in relation to obligations**
>
> A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

13. Directors will be able to rely on the safe harbour only if they are facing significant liquidity problems because of the impact of COVID 19. All other obligations and duties under the CA must still be complied with, including the duty to always act in the best interests of the company.

14. The safe harbour provisions are in schedule 12 to the CA and set out in full in the Appendix. The purpose of the safe harbour is described in cl 1 of schedule 12:

> **1 Purpose of schedule**
>
> (1) The purpose of this schedule is to give to directors of companies that are facing significant liquidity problems because of the effects of the outbreak of COVID 19 more certainty about their duties when—
>
> (a) agreeing to the business of the company being carried on or causing or allowing the business of the company to be carried on; and
>
> (b) agreeing to the company incurring obligations.
>
> (2) However, it is not a purpose of this schedule to facilitate the ability of a company that has no realistic prospect of continuing to trade or operate in the medium or long term to defer a decision to enter into liquidation to the detriment of its creditors.

15. Under cl 5 of schedule 12 the safe harbour period starts on 3 April 2020 and ends on the close of 30 September 2020 (or later, if the period is extended by regulation). In general (subject to some exclusions), cl 4 provides that the safe harbour provisions will apply to only a company that:

- as at 31 December 2019, was able to pay its debts as they became due in the normal course of business; or
- was incorporated on or after 1 January 2020 but before 3 April 2020.

16. Clause 6 of schedule 12 sets out the safe harbour relating to reckless trading (s 135 of the CA). The clause applies when a director of a company during the safe harbour period:

- agrees to the business of the company being carried on in any manner; or
- causes or allows the business of the company to be carried on in any manner.

17. Clause 6(2) provides that the actions of a director will not breach s 135 of the CA if, at the time of taking the action, the director, in good faith, is of the opinion that:

(a) the company has, or in the next six months is likely to have, significant liquidity problems;

(b) the liquidity problems are, or will be, a result of the effects of COVID 19 on the company, its debtors, or its creditors; and

(c) it is more likely than not that the company will be able to pay its due debts on and after 30 September 2021 (or a later date prescribed by regulation).

[1] Companies Office, "'Safe harbour' for company directors" (web page, 2020, **https://companies-register.companiesoffice.govt.nz/help-centre/company-directors/safe-harbour-for-company-directors/**).

BINDING RULINGS

18. Clause 7 of schedule 12 relates to the duty in relation to obligations in s 136 of the CA and will apply to a director of a company who:
    - during the safe harbour period, agrees to the company incurring an obligation; and
    - at that time, is, in good faith, of the opinion that the company has, or in the next six months is likely to have, significant liquidity problems.
19. Clause 7(2) provides that for the purposes of s 136 of the CA, the director has reasonable grounds to believe the company will be able to perform the obligation when it is required to do so if the director, in good faith, is of the opinion that:
    (a) the liquidity problems are, or will be, a result of the effects of COVID 19 on the company, its debtors, or its creditors; and
    (b) it is more likely than not that the company will be able to pay its due debts on and after 30 September 2021 (or a later date prescribed by regulation).
20. In summary, the safe harbour provisions provide that directors' decisions to carry on business, and decisions to incur new obligations, from 3 April 2020 to the close of 30 September 2020 (unless extended by regulation), will not result in a breach of duties if:
    - the directors consider in good faith that the company is facing or is likely to face significant liquidity problems in the next six months because of the impact of COVID 19 on the company or its creditors;
    - the company was able to pay its debts as they fell due on 31 December 2019 (or the company was incorporated on or after 1 January 2020 but before 3 April 2020); and
    - the directors consider in good faith that it is more likely than not that the company will be able to pay its debts as they fall due within 18 months (for example, because trading conditions are likely to improve or the company is likely to able to reach an accommodation with its creditors).
21. The safe harbour provisions are not designed to support an entity that has no realistic prospect of continuing to trade by deferring a decision about liquidation to the detriment of its creditors.
22. It is possible (if not likely) that despite the existence of the safe harbour, some companies will still face insolvency and be unable to pay their tax liabilities. This raises the issue of whether a director of a company who has made decisions in reliance of the safe harbour, or a relevant shareholder of the company, could be liable for the tax liability under s HD 15 of the ITA or s 61 of the GSTA.
23. It would be surprising for Parliament to have enacted the safe harbour to allow directors of companies adversely affected by COVID 19 to make certain decisions without breaching their duties under the CA, if relying on the safe harbour, without more, would be enough to result in liability under other legislation, such as s HD 15 of the ITA or s 61 of the GSTA.

Application of the legislation

Section HD 15

24. Section HD 15 of the ITA (asset stripping of companies) permits income tax owing by a company to be recovered from the company's directors and shareholders where an arrangement has been entered into that has an effect that the company cannot meet a tax liability. Section 61 of the GSTA is the corresponding provision in relation to GST. It provides that s HD 15 of the ITA applies as if "income tax" and "tax" read "goods and services tax". In the following analysis, references to s HD 15 should be read as also applying to s 61. Both provisions are set out in the Appendix.
25. Section HD 15(1) of the ITA sets out when the section applies:

> (1) This section applies when—
>
> (a) an arrangement has been entered into in relation to a company; and
>
> (b) an effect of the arrangement is that the company cannot meet a tax liability (the tax obligation) whether existing at the time of the arrangement or arising after that time, for—
>
> (i) income tax:
>
> (ii) a civil penalty, as defined in section 3(1) of the Tax Administration Act 1994:
>
> (iii) an amount payable under Part 7 of that Act; and
>
> (c) it is reasonable to conclude that—
>
> (i) a purpose of the arrangement is to have the effect described in paragraph (b); and
>
> (ii) if a director of the company at the time of the arrangement made reasonable inquiries, they could have anticipated at the time that the income tax liability would, or would likely, be required to be met.

26. For s HD 15 of the ITA to apply, four requirements must be satisfied:
  - An arrangement is entered into in relation to a company (including a trustee company).
  - The arrangement has an effect that the company cannot meet a tax liability (either an existing liability or one that arises later).
  - It is reasonable to conclude that a purpose of the arrangement is that the company cannot meet or will not be able meet a tax liability.
  - It is reasonable to conclude that if a director of the company at the time of the arrangement had made reasonable inquiries, they could have anticipated that the tax liability would, or would likely, be required to be met.
27. If these four requirements are met, the remaining subsections of the provision, set out when the directors and certain shareholders of the company can be treated as agents of the company in relation to the unpaid tax. Each of these requirements is discussed in turn below.

Arrangement has been entered into in relation to a company.

28. Section HD 15(1)(a) of the ITA requires an arrangement to have been entered into in relation to a company.

Meaning of an "arrangement"

29. An "arrangement" is defined in s YA 1 of the ITA:

> **arrangement** means an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect

30. The definition of arrangement provides for varying degrees of formality and enforceability. For example, an arrangement may be:
  - a legally binding contract;
  - an agreement or plan that may or may not be legally binding;
  - an understanding that may or may not be legally binding; or
  - a contract that is not enforceable at law due to public policy, contractual incapacity or illegality.
31. The courts have considered the predecessor definitions of arrangement to that in s YA 1 of the ITA, particularly in the context of the general anti-avoidance provision. They described an arrangement as embracing all kinds of concerted action by which persons may arrange their affairs for a particular purpose or to produce a particular effect (see, for example, the decision of Richardson P in the Court of Appeal in *CIR v BNZ Investments Ltd* [2002] 1 NZLR 450)
32. An arrangement may involve more than one transaction or document. Whether two or more transactions or documents together constitute an arrangement is a matter of fact (*Peterson v CIR* [2005] UKPC 5 at [33]).
33. In determining whether transactions or documents (or both) are part of an arrangement, the courts generally ask whether:
  - the transactions or documents are:
    - sufficiently interrelated or interdependent (or both);
    - part of an overall plan to obtain a particular objective or outcome; or
  - there is prior planned linking or sequencing (or both) of the documents or transactions.
34. However, a mere sequence of events without overall planning is not sufficient to constitute an arrangement. In *AMP Life Ltd v CIR* (2000) 19 NZTC 15,940 (HC), McGechan J stated:

> [125] The four steps do not amount to a "contract, agreement, plan, or understanding". They are a **mere sequence of events, each with knock-on causative consequences**, but that situation does not suffice. The concepts of contract, agreement, plan or understanding predicate some prior planned linking or sequencing or both, and that element is absent.
>
> [126] … This is a sequence of events. It is the way things eventuated. It cannot be strained to fit within concepts involving overall planning such as contracts, agreements, plans or understanding. **The legislation is not aimed at simple sequences of events of this character without prior overall planning**. These happen, and are allowed for on the basis of experience, within the tax base. The legislation is concerned with planned measures, not allowed for, which degrade the tax base. [Emphasis added]

35. Therefore, an arrangement requires an overall plan or some prior planned linking or sequencing (or both) of transactions or documents.
36. Other aspects of an arrangement include the following:
  - An arrangement is defined to include a "plan", which could involve a single person (*Russell v CIR* (No 2) (2010) 24 NZTC 24,463 (HC) (footnote 33 at [101]) and *Russell v CIR* [2012] NZCA 128 (at [54]).

- An arrangement does not require a consensus or a meeting of minds of two or more people, so a taxpayer could be party to an "arrangement" even if they are not consciously involved in or aware of the details (*Peterson* at [34]).
- An arrangement may consist of more than one agreement, contract, plan or understanding, so an agreement, contract, plan or understanding may be part of a wider arrangement as well as being part of a separate narrower arrangement.
- An arrangement includes steps and transactions that are entered into or carried out outside New Zealand (*BNZ Investments Ltd v CIR* (2000) 19 NZTC 15,732 (HC) at [123]).

37. When analysing the potential application of s HD 15 of the ITA in relation to the safe harbour, it is useful to keep in mind three potential arrangements:
    - The directors of a company facing significant liquidity problems because of the impact of COVID 19, decide, in good faith, to rely on the safe harbour and continue operating. Of itself, this may not be an "arrangement" – it may simply be a decision made by the directors. However, it could be a "plan", which is included in the definition of "arrangement" in s YA 1 of the ITA.
    - As a result of the directors' decision, the company continues to trade or takes on new obligations (for example, bank loans or sales at credit). A company simply engaging in trade is likely to be a mere sequence of events, so may be insufficient to be an "arrangement". However, any individual transaction or obligation entered into could be an "arrangement" in its own right.
    - During the safe harbour period, the directors resolve or arrange for the company to enter into an "arrangement" of a type that (of itself) would potentially be subject to s HD 15 of the ITA or s 61 of the GSTA absent the directors' decision to rely on the safe harbour.

Meaning of "in relation to"

38. Section HD 15(1)(a) of the ITA requires that an arrangement is entered into "in relation to a company".

39. On the face of it, the words "in relation to" appear to have a broad application. In *Shell New Zealand Ltd v CIR* (1994) 16 NZTC 11,303, the Court of Appeal considered that the words "in respect of or in relation to" were of the widest import. Similarly, *Claremont Petroleum NL v Cummings* (1992) 110 ALR 239 (FCA) concerned a similar phrase, "in connection with". The court in Claremont considered that the phrase referred to a relationship between two things, but not necessarily a causal relationship. A similar view was also expressed in *Strachan v Marriott* [1995] 3 NZLR 272 (CA), where the court stated that the meaning of phrases such as "in connection with", "in relation to" and "in respect of" depend on the context in which the phrases are used. Hardie Boys J said (at 279):

    > "In connection with" may signify no more than a relationship between one thing and another. The expression does not necessarily require that it be a causal relationship: *Our Town FM Pty Ltd v Australian Broadcasting Tribunal* (1987) 16 FCR 465, 479 per Wilcox J. But, as Davies J warned in *Hatfield v Health Insurance Commission* (1987) 15 FCR 487, at p 491:
    >
    >> "Expressions such as 'relating to', 'in relation to', 'in connection with' and 'in respect of' are commonly found in legislation but invariably raise problems of statutory interpretation. They are terms which fluctuate in operation from statute to statute. ... The terms may have a very wide operation but they do not usually carry the widest possible ambit, for they are subject to the context in which they are used, to the words with which they are associated, and to the object or purpose of the statutory provision in which they appear."

40. The phrase "in relation to" indicates that the arrangement must relate to the company itself. It would not be sufficient if the arrangement simply involves a company that is a party to an arrangement. This interpretation is supported by the language used in other parts of s HD 15 of the ITA; that is, regarding the effect of the arrangement on the company's ability to satisfy its tax liabilities.

Nature of the arrangement for s HD 15(1)(a) of the ITA

41. It is well established in case law that the arrangement for the purposes of s HD 15 of the ITA (or its earlier equivalents, s HK 11 of the Income Tax Act 1994 and s HK 11 of the Income Tax Act 2004) must involve the stripping or depletion of assets from the company. While the wording of the earlier provisions differs, the purpose and intended scope is the same as for s HD 15. For completeness, it is noted that the case law is unclear whether this is a requirement that is drawn from the language of subs (1)(a) or (b), but for current purposes it is not necessary to consider that distinction in any detail.

42. The High Court in *Spencer v CIR* (2004) 21 NZTC 18,818 considered the application of s HK 11 of the Income Tax Act 1994. In relation to the purpose of the section, Paterson J stated:

    > [34] The general purpose of s HK 11 [now s HD 15] of the Income Tax Act is to enable the Commissioner to recover tax or, in this case, GST from the directors and shareholders of a company that has **entered into an arrangement or transaction to deplete the company's assets** so that it is unable to fully meet its tax liabilities. [Emphasis added]

BINDING RULINGS

43. Similarly, in *Case X11* (2005) 22 NZTC 12,175, Judge Willy stated:

> [9] It is clear from subs. (1) that the intention of the legislature is to allow the Commission to recover tax from the directors and shareholders of a company which has **entered into an arrangement an effect or purpose of which is to deplete or strip the company's assets** so that it is unable to meet it's tax liabilities. [Emphasis added]

44. Further, in *Henderson v CIR* [2016] NZHC 1987, (2016) 27 NZTC 22,068 (HC), Gendall J referred to the stripping of assets (specifically in relation to s HD 15(1)(b) of the ITA), stating:

> *Second requirement – was it an effect of the arrangement that each company cannot meet a tax liability?*
>
> [61] Under s 61 of the GST Act an effect of the arrangement must be that the company in question cannot meet a tax liability (either an existing liability or one that arises later).
>
> [62] In this case the sale to the Council of the properties concerned converted the assets of the companies from land and buildings to cash. **There can be no doubt that the net sale proceeds were then stripped from the companies** under the arrangement and following the various transactions and steps that were taken, the companies were unable to satisfy their GST debts. I am left in no doubt that this was the end result of the arrangement. It is what the arrangement achieved irrespective of any motive otherwise which the appellant maintains he had. It was the effect of the arrangement and it must follow therefore that the TRA [Taxation Review Authority] was correct to find that the second requirement under s 61 is satisfied.
>
> …
>
> [65] I am satisfied that **if any purpose of the arrangement was to have the effect of stripping assets from the company,** so that they were unable to satisfy their liabilities to creditors (of which their tax liability is one), then that is a sufficient purpose for this requirement to be met. It is not necessary that the purpose is the dominant or principal purpose. [Emphasis added]

45. The requirement that the "arrangement" involve the depletion or stripping of assets is also consistent with contextual and extrinsic material. The section heading of s HD 15 of the ITA is "asset stripping of companies", which is an indication from Parliament regarding the focus of the provision.

*46. The business tax policy document released with the 1991 Budget (T*axation Policy – Business Tax Policy 1991 (Ministers of Finance and Revenue, 30 July 1991)) referred to the need for the arrangement to involve the depletion or stripping of assets:

> ***Chapter 10: Tax Recovery***
>
> *Introduction*
>
> This chapter provides more information on the Government's decision to replace section 276 of the Income Tax Act with a better targeted tax recovery provision. **That new provision [what is now s HD 15] will enable the Commissioner to recover tax from the directors and shareholders of a company that has entered into an arrangement or transaction to deplete the company's assets so that it is unable to fully meet its tax liabilities.**
>
> ...
>
> **The new recovery provision will be triggered by arrangements or transactions that have been entered into to deplete the company of its assets so that it has insufficient funds to fully meet its tax liabilities.** However, it will not be triggered by formal arrangements (under insolvency proceedings) or informal arrangements (under section 414A of the Income Tax Act) between the Commissioner of Inland Revenue, the company and its other creditors, which result in the Commissioner accepting less than the full amount of tax outstanding. [Emphasis added]

47. Similarly, *Tax Compliance* (Report to the Treasurer and Minister of Revenue by a Committee of Experts on Tax Compliance, December 1998) states:

> 11.45 Section HK 11 is directed at arrangements **which deplete a company's assets** so that it is unable to meet its tax liabilities. The company is often liquidated as part of the arrangement, or simply because after a transaction is completed, the company serves no useful purpose. … [Emphasis added]

48. Finally, the Commissioner has taken a similar approach, in "Tax recovery provision: Application to civil penalties and interest" (*Tax Information Bulletin* Vol 17, No 7 (September 2005): 44) stating:

> Section HK 11 of the Income Tax Act 2004 is directed at arrangements which **deplete a company's assets** so that it is unable to meet its tax liabilities. [Emphasis added]

49. This material strongly suggests that a company's directors simply making a decision, in good faith, for the company to continue to carry on business, or to enter into an obligation due to the existence of the safe harbour will not be sufficient for s HD 15 of the ITA to apply. Similarly, a company carrying on trading or entering into obligations at a time when the directors believe, in good faith, that the requirements of the safe harbour are met will not fall within the scope of s HD 15. For s HD 15 to apply, it is necessary for the arrangement in question to involve the assets of the company being stripped or depleted.

Effect of the arrangement is that the company cannot meet a tax liability

50. The second requirement is that an effect of the arrangement must be that the company cannot meet a tax liability (s HD 15(1)(b) of the ITA).

Meaning of "effect"

51. The term "effect" has been discussed in the context of anti-avoidance provisions. In *Auckland Harbour Board v CIR* (1999) 19 NZTC 15,433 (CA), delivering the majority judgment of the Court of Appeal, Richardson P said (at 15,451) that "effect" meant the end accomplished or achieved:

> In context, we consider it [the word "effect"] has its standard meaning of "the end accomplished or achieved" (*Newton v C of T* (1958) AC 450 at p465).

52. Similarly, in his dissenting judgment in *CIR v BNZ Investments Ltd* (2001) 20 NZTC 17,103 (CA), Thomas J said (at 17,132) that the word "effect" directed focus to the result or consequence of an arrangement:

> **The word "effect" directs the focus to the result or consequence of the arrangement as opposed to a bare description of tax avoidance. It focuses on the physical characteristics of the arrangement.** (See The Valabh Committee, Key Reforms to the Scheme of Tax Legislation, Discussion Paper, October 1991, paras 3.5, and 3.6). The Courts have also held that the purpose of an arrangement is to be determined by its effect. It is sufficient to refer to the succinct statement of Woodhouse P in the *Challenge Corporation* case (at p 533): "I am satisfied as well that the issue... is something to be decided, not subjectively in terms of motive, but objectively by reference to the arrangement itself." [Emphasis added]

53. The approach taken by Thomas J was later endorsed by the Privy Council in *Peterson* at 34. Thomas J also said that the word "effect" focused on the physical characteristics of the arrangement.

54. In *Newton v FCT* [1958] 2 All ER 759 (PC), Lord Denning said (at 764) that you must look at the arrangement itself to see its effect—what it does—irrespective of the motives of the persons who made the arrangement:

> ... In applying the section you must, by the very words of it, **look at the arrangement itself and see which is its effect – which it does – irrespective of the motives of the person who made it.** Mr Justice Williams put it well when he said:
>
> > "The purpose of a contract, agreement, or arrangement must be what it is intended to effect and that intention must be ascertained from its terms. Those terms may be oral or written or may have to be inferred from the circumstances but, when they have been ascertained, their purpose must be what they effect." [Emphasis added]

55. In summary, an effect of an arrangement is a result or consequence of the arrangement (in other words – what the arrangement does). Determining an effect of an arrangement is an objective test having regard to the outcome or outcomes of the arrangement itself. The motives of the parties are irrelevant. This determination is highly fact specific.

56. The word "effect" should be interpreted similarly in s HD 15 of the ITA. Determining an effect of an arrangement is an objective test having regard to the outcome or outcomes of the arrangement rather than the motives of the parties.

57. Section HD 15(1)(b) of the ITA refers to **an** effect of the arrangement. The use of the indefinite article "an" with the noun "effect" implies that the required effect may be one of multiple effects of the arrangement, irrespective of its prominence or its incidental nature. It need not be the sole, dominant, or principal effect. This means any arrangement that results in a company being unable to meet its tax obligations will have the requisite effect.

Meaning of "tax liability"

58. Section HD 15(1)(b) of the ITA requires that an effect of the arrangement is that the company cannot meet a tax liability.

59. The term "tax liability" is not defined in the ITA, GSTA or Tax Administration Act 1994. However, a tax liability is a key concept explained in the core provisions of the ITA. Under s BC 6 of the ITA the income tax liability for a filing taxpayer is the amount calculated by "multiplying their taxable income for the tax year by the basic rate of tax" (this is modified for scheduler income under s BC 7 of the ITA).

60. Section HD 15(1)(b) of the ITA defines the concept of a "tax obligation" as being a tax liability of the company that cannot be met as a result of the arrangement. That tax obligation can exist at the time of the arrangement or arise after the arrangement has been entered into. The tax liability must be for income tax (or GST by virtue of s 61 of the GSTA), a civil penalty, or interest.

Meaning of "cannot meet"

61. Based on the definitions of "can", "cannot" and "not" in the *Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York, 2011), the ordinary meaning of "cannot" is not able to do something. The relevant meaning of the word "meet", according to that same dictionary, is to "fulfil or satisfy" a requirement or condition. Accordingly, under s HD 15 of the ITA an effect of the arrangement must be that the company is unable to fulfil or satisfy a tax liability.

62. This is consistent with the wording used in earlier equivalents of s HD 15, with s HK 11 of the Income Tax Act 1994 and s HK 11 of the Income Tax Act 2004 using the words "unable to satisfy".

63. Arguably, any arrangement that results in a company not being able to pay its tax will satisfy the requirement of s HD 15(1)(b) of the ITA. However, of itself this is not enough to conclude that the section will apply.

Whether it is reasonable to conclude that a purpose of the arrangement is that the company cannot meet a tax liability

64. The third requirement is that it is reasonable to conclude that a purpose of the arrangement is to have the effect that the company cannot meet a tax liability (s HD 15(1)(c)(i) of the ITA). The focus is on the purpose of the arrangement not the motive of any person.

65. Whether something is reasonable involves an objective test (see **Vinyl Processors (New Zealand) Ltd v Cant** [1991] 2 NZLR 416 (HC) at 420 and 421). What is reasonable may vary depending on the factual situation.

66. The way in which a purpose test is to be applied and the factors relevant in ascertaining purpose depend on the statutory context (*CIR v Haenga* (1985) 7 NZTC 5,198 (CA)).

67. The meaning of the purpose of an arrangement has been considered in the context of the general anti avoidance provision s BG 1 of the ITA and earlier equivalent provisions.

68. In an avoidance context, the courts have held that the "purpose or effect" of an arrangement is determined objectively and the motives or intentions of the parties are not relevant. In that context, the courts have held that the purpose of an arrangement is the effect that is sought to be achieved or its intended effect.

69. This is evident from the decision of the Supreme Court in *Glenharrow Holdings Ltd v CIR* [2008] NZSC 116, [2009] 2 NZLR 359:

> [35] ... Secondly, the Commissioner must have been properly satisfied that the arrangement was entered into between the parties to it to defeat the intent and application of the Act or any provision of the Act. **This does not mean that the Commissioner must have been satisfied that the parties subjectively had that defeating purposes**, i.e that they were consciously trying to achieve the end of defeating the intent and application of the Act. ...
>
> [36] A natural and sensible reading of s 76 [of the GSTA], as it stood prior to 2000, is to read it as requiring the Commissioner to be satisfied that an arrangement has been entered into between persons "so as to" defeat the intent and application of the Act or any provision of the Act. **That requires the Commissioner and the Court to ask what objectively was the purpose of the arrangement, which in turn requires examination of the effect of the arrangement.** Section 76, even in its pre-2000 version, therefore requires an examination of the purpose or effect of the arrangement, and in this respect the current version of the section has merely stated expressly what was implicit in the former version.
>
> …
>
> [38] … the general anti avoidance provision was concerned not with the purpose of the parties, but with the purpose of the arrangement. That is a crucial distinction. Once you put the purpose of the parties to one side and seek by objective examination to find the purpose of the arrangement, you must necessarily do that by considering the effect which the arrangement has had — what it has achieved — and then, **by working backwards as it were from the effect, you are able to determine what objectively the arrangement must be taken to have had as its purpose**. That approach is inevitable once any subjective purpose or motive is ruled out of contention, as the authorities say it must be. [Emphasis added]

70. The High Court in *Henderson* confirmed that in s HD 15 of the ITA the purpose needs to be determined objectively:

> [64] **Here the determination of a purpose of an arrangement requires an objective examination. In deciding what the purpose or purposes of an arrangement are it is necessary to consider what it achieved, that is the end result. It must then be considered whether that was one of the things the arrangement was designed to achieve.**
>
> [65] I am satisfied that if any purpose of the arrangement was to have the effect of stripping assets from the company, so that they were unable to satisfy their liabilities to creditors (of which their tax liability is one), then that is a sufficient purpose for this requirement to be met. It is not necessary that the purpose is the dominant or principal purpose.
>
> [66] Here, the companies were insolvent at the relevant time. They could not pay both the GST and their other unsecured creditor, ILR. That part of the arrangement that involved disbursing the net sale proceeds to ILR (and subsequently to PVL and then its creditors and the creditors of its subsidiaries) left the companies with no assets. This resulted in them being unable to pay their GST liabilities. **Irrespective of the stated motive of the appellant, objectively that was the outcome of the arrangement, and that was the end result the arrangement was designed to achieve. It must be accepted therefore that it was a purpose of that part of the arrangement. It is reasonable to conclude therefore that an objective purpose of the arrangement was to have the effect that the companies could not meet their GST liabilities.**
>
> [67] Effectively here, the companies were insolvent at the time and it cannot be right that they can enter into arrangements as a result of which they receive windfall amounts they would otherwise not be entitled to and then use such amounts for their own purposes without paying their tax liabilities. [Emphasis added]

71. However, there is a key difference in the wording of s HD 15 of the ITA and the general anti-avoidance provision. Section HD 15(1)(c)(i) refers only to the relevant arrangement's purpose and requires that a purpose of the arrangement **is to have the effect** described in s HD 15(1)(b); that is, that the company cannot meet a tax liability. Section HD 15(1)(c)(i) does not require the purpose **to be** that effect (such an interpretation would render para (c) redundant and to the same effect as para (a)). The wording of s HD 15(1)(c)(i) suggests that the required purpose must be the arrangement's intended purpose; not simply the ultimate outcome. This is supported by the decision of the High Court in *Henderson*, where Gendall J referred to the "end result the arrangement was designed to achieve".

72. Whether the arrangement has the required purpose therefore involves considering whether the outcome or end result (effect) of the arrangement was what the arrangement was designed to achieve, objectively determined. This consideration will be highly fact specific.

73. Section HD 15(1)(c)(i) of the ITA uses an indefinite article in the phrase "**a** purpose of the arrangement" (emphasis added). This means it will be sufficient if any purpose of the arrangement was that the arrangement would have an effect involving the depletion of the assets of a company with the result that the company cannot meet an existing or future tax liability. It is not necessary for this purpose to have been the sole, dominant, or principal purpose.

74. This strongly suggests that ordinary business dealings – in terms of a company trading or entering into obligations in reliance of the safe harbour – will not generally be subject to s HD 15 of the ITA or s 61 of the GSTA. To the extent that such dealings – together with the decision to utilise the safe harbour – are an "arrangement entered into in relation to a company", it would not be reasonable to conclude that that arrangement alone had been designed with a purpose of the company being unable to pay a tax liability. This is supported by the fact it is a requirement of the safe harbour that a director be of the opinion, in good faith, that the company will be in a position to meet its debts on and after 30 September 2021.

75. We note, however, that the fact a company's directors decide to rely on the safe harbour will **not** prevent s HD 15 of the ITA or s 61 of the GSTA from applying to any arrangement that would ordinarily be caught by the relevant provision. Any arrangement designed with a purpose of achieving the end result of avoiding a tax liability would still be subject to the application of s HD 15 or s 61.

Whether it is reasonable to conclude that a director could have anticipated the tax liability

76. The fourth requirement is that it is reasonable to conclude that if a director of the company at the time of the arrangement made reasonable inquiries they could have anticipated at the time that the tax liability would, or would likely, be required to be met (s HD 15(1)(c)(ii) of the ITA).

77. As noted above, whether something is reasonable involves an objective test and what is reasonable may vary depending on the factual situation. The inquiry for the purposes of s HD 15(1)(c)(ii) of the ITA is based on the circumstances that existed at the time of the arrangement.

78. It must be possible for the director to have anticipated that the tax liability would or would likely be required to be met. In *Commissioner of Police v Ombudsman* [1985] 1 NZLR 578 (HC) Jeffries J said (at 589) that the words "would be likely" as used in s 6 of the Official Information Act 1982 meant there was a distinct or significant possibility the result might occur:

> The words "would be likely" I consider mean that there is a distinct, or significant possibility the result might occur, but no higher than that. On the scale of probability it is above a slight chance and below an expectation. It suggests, in my view, without question mentally conceivable.

79. Adopting a similar approach to Jeffries J, for the purposes of s HD 15(1)(c)(ii), the director must have been able to anticipate that:

- the relevant tax liability would be required to be met; or
- there was a distinct or significant possibility that the relevant tax liability would be required to be met.

80. Of itself, this final requirement is not overly helpful in this context.

Conclusion

81. As set out above, for s HD 15 of the ITA (and therefore s 61 of the GSTA) to apply, four requirements must be satisfied:
    - An arrangement is entered into in relation to a company.
    - The arrangement has an effect that the company cannot meet a tax liability (either an existing liability or one that arises later).
    - It is reasonable to conclude that a purpose of the arrangement is that the company cannot meet or will not be able meet a tax liability.
    - It is reasonable to conclude that if a director of the company at the time of the arrangement made reasonable inquiries, they could have anticipated that the tax liability would, or would likely, be required to be met.
82. Determining the effect and intended purpose of an arrangement is highly fact specific.
83. Considering the four requirements, for s HD 15 of the ITA or s 61 of the GSTA to apply, it is necessary for the arrangement to:
    - involve the depletion of the assets of a company; and
    - be designed to have the effect that the company cannot pay a tax obligation.
84. Section HD 15 of the ITA or s 61 of the GSTA will not apply to a company that is unable to pay a tax obligation where:
    - the directors of a company facing significant liquidity problems because of the effects of COVID 19 and the resulting economic climate decide in good faith to rely on the safe harbour and continue carrying on business; or
    - as a result of the directors' decision to rely on the safe harbour, the company continues carrying on business and trading, or incurs new obligations on ordinary commercial business terms (for example, bank loans or sales at credit).
85. However, s HD 15 of the ITA and s 61 of the GSTA will still apply to any arrangement that would ordinarily be subject to the provision, notwithstanding that the arrangement was entered into during the safe harbour period following a company's directors' decision to rely on the safe harbour.

Examples

86. The following examples illustrate the general approach to the application of s HD 15 of the ITA and s 61 of the GSTA in the context of the COVID 19 safe harbour.

Example One: section HD 15 of the Income Tax Act 2007 does not apply

Shoe Co is a retail company that is facing significant liquidity problems due to the impact of COVID 19. The directors of Shoe Co seek advice from their lawyers. The lawyers advise that Shoe Co can continue trading on the basis that:

- the directors consider, in good faith, that Shoe Co is facing significant liquidity issues as a result of COVID 19;
- Shoe Co was able to pay its debts as they fell due in the normal course of business on 31 December 2019; and
- the directors consider, in good faith, that it is more likely than not that Shoe Co will be able to pay its debts as they fall due on and after 30 September 2021.

In May 2020, the directors resolve to keep trading and document their reliance on the safe harbour exemption. The directors are confident that the company will return to profitability within the next 18 months.

Shoe Co enters into a long-term loan with the bank so they have funds to pay staff and carry out important maintenance work. Shoe Co also negotiates an instalment arrangement with the Commissioner in relation to an income tax obligation that arose before New Zealand's COVID-19 lockdown.

Ultimately, these steps prove insufficient to save Shoe Co, and the directors resolve to place the company into liquidation. At that time, Shoe Co's assets are inadequate for it to fully meet its outstanding debts. Nearly half of the income tax obligation remains outstanding and cannot be paid.

Shoe Co has a tax liability that cannot be met, but there is no arrangement that has the purpose of depleting Shoe Co's assets in a way that is designed to have the effect that the tax liability could not be met. Accordingly, s HD 15 of the Income Tax Act 2007 does not apply.

Example Two: Section 61 of the Goods and Services Tax Act 1985 could apply

Food Co has operated a successful restaurant near a popular tourist spot for several years.

Food Co saw a significant downturn in business due to the impact of COVID 19. In May 2020, it was struggling to pay its debts as they became due. In June 2020, the directors of Food Co resolved to continue trading despite Food Co's financial difficulties, taking comfort that they were within the newly enacted safe harbour in schedule 12 of the Companies Act 1993. At that time, the directors were of the view, in good faith, that Food Co:

- was facing significant liquidity issues as a result of COVID 19;
- was able to pay its debts as they fell due in the normal course of business on 31 December 2019; and
- would return to profitability once overseas tourists were able to return, so it is more likely than not that Food Co will be able to pay its debts as they fall due on and after 30 September 2021.

Later in 2020, Food Co's situation has somewhat improved. The directors, however, remained concerned about the long-term prospects for Food Co. At that time, the directors resolve to sell the assets of the company to John, the sole shareholder in Food Co. Rather than selling the assets for market value, they resolve to sell them to John for a nominal sum. Following the sale, Food Co has insufficient funds to pay the GST owing on the sale of the assets (which is treated as have been made for open market value under s 10(3)).

The sale of the assets to John is an arrangement entered into in relation to Food Co that has the purpose of depleting Food Co's assets. An effect of the arrangement is that Food Co is unable to pay its GST obligations, as it has insufficient funds to fully pay the GST due on the sale of the assets. Objectively, that effect is a purpose of the arrangement, and therefore s 61 of the GSTA could apply.

References

Subject references

COVID 19 safe harbour
Directors' liability

Legislative references

Companies Act 1993, ss 135, 136, 138B, schedule 12
Goods and Services Tax Act 1985, s 61
Income Tax Act 1994, s HK 11
Income Tax Act 2004, s HK 11
Income Tax Act 2007, s HD 15
Official Information Act 1982, s 6
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Appendix: Legislation

Income Tax Act 2007

1. Section HD 15 states:

HD 15 Asset stripping of companies

When this section applies

(1) This section applies when—

(a) an arrangement has been entered into in relation to a company; and

(b) an effect of the arrangement is that the company cannot meet a tax liability (the tax obligation) whether existing at the time of the arrangement or arising after that time, for—

(i) income tax:

(ii) a civil penalty, as defined in section 3(1) of the Tax Administration Act 1994:

(iii) an amount payable under Part 7 of that Act; and

(c) it is reasonable to conclude that—

(i) a purpose of the arrangement is to have the effect described in paragraph (b); and

(ii) if a director of the company at the time of the arrangement made reasonable inquiries, they could have anticipated at the time that the income tax liability would, or would likely, be required to be met.

When this section does not apply

(2) This section does not apply to an arrangement if—

(a) the Commissioner is a party to the arrangement:

(b) the tax obligation is no more than an amount of income tax that arises as a direct result of the performance of the arrangement, and that obligation has been met:

(c) at the time of the arrangement, the company was under statutory management under the Reserve Bank of New Zealand Act 1989 or the Corporations (Investigation and Management) Act 1989.

Director's liability

(3) All persons who are directors of the company at the time the arrangement is entered into are treated as agents of the company in relation to the tax obligation, and the liability is joint and several. But a director has no liability if—

(a) they do not derive a benefit from the arrangement, and at the first reasonable opportunity after becoming aware of the arrangement, or the aspects of the arrangement that cause this section to apply to it, they record formally their dissent in relation to the arrangement with the company and with the Commissioner; or

(b) they were not at the relevant time involved in the executive management of the company and had no knowledge of the arrangement, or the aspects of the arrangement that cause this section to apply to it.

Shareholder's liability

(4) A person who is a controlling shareholder or an interested shareholder at the time of the arrangement is treated as an agent of the company in relation to the tax obligation other than penalties and interest but, despite section HD 3(2), the liability is limited to the greater of—

(a) the market value of the person's direct and indirect shareholding in the company at the time of the arrangement; and

(b) the value of the benefit that the person derives from the arrangement.

Shareholder's liability for penalties and interest

(5) A person who is a controlling shareholder or an interested shareholder at the time of the arrangement is treated as an agent of the company in relation to penalties and interest in proportion to their liability for the tax obligation under subsection (4).

Company liquidations

(6) In order to give effect to this section, if a company has been liquidated, the Commissioner may at any time after the liquidation make an assessment of a company for an income tax liability of the company as if it had not been liquidated. The time bar applies, but this subsection overrides other provisions in this Act and the Tax Administration Act 1994.

Agents for purposes of notification or objection procedures

(7) In making an assessment under subsection (6), the Commissioner must nominate 1 or more persons as having the tax obligation set out in the assessment. The nominated person or persons are treated as agents of the company in relation to any notification or objection procedure concerning the assessment.

When liability does not arise

(8) No liability arises under this section for a tax year in relation to which—

(a) a company has provided returns within the time allowed by section 37 of the Tax Administration Act 1994 for providing returns for the tax year in which the company is liquidated; and

(b) the Commissioner has not issued a notice of assessment of the company for the tax year before the end of 4 years following the end of the tax year in which the company is liquidated.

Meaning of company in voting interest or market value interest tests

(8B) When applying sections YC 2 to YC 6 (which relate to voting and market value interests) for the purposes of the definitions of controlling shareholder and interested shareholder in subsection (9), the reference to company in sections YC 2 to YC 6 includes a company that is acting in the capacity of trustee.

Some definitions

(9) In this section,—

company includes a company that is acting in the capacity of trustee

controlling shareholder, for a company, means—

(a) a person whose voting interest or market value interest in the company at the time of the arrangement, together with any interests of an associated person, is 50% or more; and

(b) if the person or associated person is a company, the voting interest or market value interest of the person or associated person is calculated as if they were not a company and as if sections YC 4 (Look-through rule for corporate shareholders) and YC 6 did not apply

director means,—

(a) a person who occupies the position of director, whether or not the position has that title:

(b) for an entity that is treated as a company under this Act, a person who acts in the same or similar way as a director would if the entity were a company incorporated in New Zealand under the Companies Act 1993

interested shareholder means a person who, at the time the arrangement is entered into, has a voting interest or market value interest in the company, calculated in either case if the person is a company as if the person were not a company, and because of the size of the benefit that the person derives from the arrangement, it is reasonable to conclude that the person is a party to the arrangement

penalties and interest means a civil penalty or amount payable under Part 7 of the Tax Administration Act 1994 that is part of the tax obligation.

Goods and Services Tax Act 1985

2. Section 61 states:

61 Liability for tax payable by company left with insufficient assets

Section HD 15 of the Income Tax Act 2007, with any necessary modifications, applies for the purpose of this Act as if the terms income tax or tax read goods and services tax.

Companies Act 1993

3. Section 135 states:

135 Reckless trading

A director of a company must not—

(a) agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or

(b) cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

4. Section 136 states:

136 Duty in relation to obligations

A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

5. Section 138B states:

138B Safe harbour for directors relating to effects of COVID-19

(1) The provisions of Schedule 12 have effect according to their terms.

(2) This section and Schedule 12 are repealed on the close of 31 May 2022.

6. Schedule 12 states:

Schedule 12

Safe harbour provisions relating to outbreak of COVID-19

1 Purpose of schedule

(1) The purpose of this schedule is to give to directors of companies that are facing significant liquidity problems because of the effects of the outbreak of COVID-19 more certainty about their duties when—

(a) agreeing to the business of the company being carried on or causing or allowing the business of the company to be carried on; and

(b) agreeing to the company incurring obligations.

(2) However, it is not a purpose of this schedule to facilitate the ability of a company that has no realistic prospect of continuing to trade or operate in the medium or long term to defer a decision to enter into liquidation to the detriment of its creditors.

2 Overview of schedule

(1) This schedule applies in relation to actions of directors of certain companies during safe harbour periods.

(2) Subclause (1) is only a guide to the overall scheme and effect of this schedule.

3 Interpretation

In this schedule, unless the context otherwise requires,—

action includes omission

commencement date means the commencement date of section 138B

company in BDH means a company to which the protections in Part 5 of Schedule 13 apply

Ministers means the Minister of Finance and the Minister of the Crown who, under the authority of a warrant or with the authority of the Prime Minister, is responsible for the administration of this Act, acting jointly

reaching a compromise or other arrangement includes a proposed arrangement being approved by the company's creditors under Schedule 13

safe harbour period has the meaning set out in clause 5.

Application of safe harbour provisions

4 Companies to which safe harbour provisions apply

(1) Clauses 6 and 7 apply to a company (including a company in BDH) if,—

(a) as at 31 December 2019 (or any later benchmark date prescribed in regulations for a new safe harbour period), the company was able to pay its debts as they became due in the normal course of business; or

(b) the company was incorporated on or after 1 January 2020 but before 3 April 2020.

(2) However, clauses 6 and 7 do not apply to a company that is—

(a) a registered bank within the meaning of section 2(1) of the Reserve Bank of New Zealand Act 1989:

(b) a licensed insurer:

(c) an NBDT within the meaning of section 5 of the Non-bank Deposit Takers Act 2013:

(d) a qualifying counterparty within the meaning of section 122A of the Reserve Bank of New Zealand Act 1989:

(e) a company incorporated on or after 3 April 2020:

(f) a company of a class prescribed in any regulations made under clause 9.

(3) In addition, clauses 6 and 7—

(a) do not apply in the circumstances, or to the transactions, prescribed in any regulations made under clause 9; and

(b) cease to apply if conditions prescribed in any regulations made under clause 9 are not satisfied.

5 Meaning of safe harbour period

(1) In this schedule, safe harbour period means—

(a) the initial safe harbour period; and

(b) if regulations are made under clause 10(1)(b), the new safe harbour period.

(2) The initial safe harbour period means the period that starts on 3 April 2020 and ends—

(a) on the close of 30 September 2020; or

(b) if regulations are made under clause 10(1)(a), on the close of the date to which the period is extended.

(3) The new safe harbour period means the period prescribed in the regulations made under clause 10(1)(b).

Safe harbour provisions

6 Safe harbour relating to reckless trading

(1) This clause applies to the following actions of a director of a company taken during a safe harbour period:

(a) agreeing to the business of the company being carried on in any manner:

(b) causing or allowing the business of the company to be carried on in any manner.

(2) The actions of the director do not breach section 135 if, at the time of taking them, the director, in good faith, is of the opinion that—

(a) the company has, or in the next 6 months is likely to have, significant liquidity problems; and

(b) the liquidity problems are, or will be, a result of the effects of COVID-19 on the company, its debtors, or its creditors; and

(c) it is more likely than not that the company will be able to pay its due debts on and after the date in subclause (3).

(3) For the purposes of subclause (2)(c), the date is—

(a) 30 September 2021; or

(b) any later date prescribed by the regulations.

(4) For the purposes of the opinion required by subclause (2)(c), the director may have regard to—

(a) the likelihood of trading conditions improving:

(b) the likelihood of the company reaching a compromise or other arrangement with its creditors:

(c) any other matters the director considers to be relevant.

(5) In this clause, regulations means regulations made under clause 10.

(6) See clause 4, for companies to which this clause applies.

7 Safe harbour relating to section 136 duty

(1) Subclause (2) applies to a director of a company—

(a) who, during a safe harbour period, agrees to the company incurring an obligation; and

(b) who, at the time of agreeing to the company incurring the obligation, is, in good faith, of the opinion that the company has, or in the next 6 months is likely to have, significant liquidity problems.

(2) For the purposes of section 136, the director has reasonable grounds to believe that the company will be able to perform the obligation when it is required to do so if the director, in good faith, is of the opinion that—

(a) the liquidity problems are, or will be, a result of the effects of COVID-19 on the company, its debtors, or its creditors; and

(b) it is more likely than not that the company will be able to pay its due debts on and after the date in subclause (4).

(3) However, subclause (2) only applies if the company incurs the obligation in the safe harbour period.

(4) For the purposes of subclause (2)(b), the date is—

(a) 30 September 2021; or

(b) any later date prescribed by the regulations.

(5) For the purposes of the opinion required by subclause (2)(b), the director may have regard to—

(a) the likelihood of trading conditions improving:

(b) the likelihood of the company reaching a compromise or other arrangement with its creditors:

(c) any other matters the director considers to be relevant.

(6) In this clause, regulations means regulations made under clause 10.

(7) See clause 4, for companies to which this clause applies.

Miscellaneous

8 Burden of proof

A person who wishes to rely on a provision of this schedule in a proceeding for, or relating to, a breach of section 135 or 136 has the burden of proving that the provision applies.

9 Regulations relating to companies, etc, to which safe harbour provisions apply

(1) The Governor-General may, by Order in Council made on the recommendation of the Ministers, make regulations that prescribe classes of companies, or classes of transactions or other circumstances, for the purposes of clause 4, including providing for either or both of the following:

(a) for clause 6 or 7, or both, to apply only if conditions prescribed in the regulations are satisfied:

(b) for clause 6 or 7, or both, to cease to apply if conditions prescribed in the regulations are not satisfied.

(2) Before recommending the making of regulations under subclause (1), the Ministers must have regard to—

(a) the provisions of clause 1 (which relates to the purpose of this schedule); and

(b) the effect of the regulations on—

(i) the creditors of companies that have significant liquidity problems; and

(ii) the integrity of corporate insolvency law.

(3) Different matters may be prescribed in respect of different classes of companies, transactions, or other circumstances.

(4) See also clause 10 (for regulations prescribing a benchmark date).

10 Regulations relating to safe harbour periods

(1) The Governor-General may, by Order in Council made on the recommendation of the Ministers, make regulations that—

(a) extend the initial safe harbour period until no later than 31 March 2021:

(b) provide for clause 6 or 7, or both, to apply for a new safe harbour period—

(i) of no more than 6 months; and

(ii) that ends no later than the close of 30 September 2021.

(2) The powers in subclause (1)(a) and (b) may each be exercised once only.

(3) However, the Governor-General may, by Order in Council made on the recommendation of the Ministers,—

(a) revoke regulations made under subclause (1) (wholly or in part):

(b) amend regulations made under subclause (1) to reduce the period of an extension or a new safe harbour period.

(4) The Ministers must not recommend the making of regulations under subclause (1) unless the Ministers—

(a) have had regard to the provisions of clause 1 (which relates to the purpose of this schedule); and

(b) are satisfied that the extension or new safe harbour period is—

(i) necessary or desirable to address the effects of COVID-19; and

(ii) no longer than is reasonably necessary to address the matters that gave rise to it.

(5) Regulations made under subclause (1)(a) may prescribe a date for the purposes of clauses 6(3) and 7(4), but that date must be no later than 31 March 2022.

(6) Regulations made under subclause (1)(b) may do either or both of the following:

(a) prescribe a benchmark date under clause 4(1)(a), being a date that is—

(i) no earlier than 30 June 2020; and

(ii) no later than the date that is 3 months before the start of the new safe harbour period:

(b) prescribe a date, for the purposes of clauses 6(3) and 7(4), but that date must be not later than 18 months after the start of the new safe harbour period.

(7) Subclauses (5) and (6) do not limit subclause (1).

BR Prd 19/03: StockCo Limited - Notice of Withdrawal of Product Ruling

This is a notice of withdrawal of a product ruling under section 91FJ of the Tax Administration Act 1994.

1. Product ruling BR Prd 19/03 is hereby withdrawn to allow for a replacement ruling to be issued.
2. Product ruling BR Prd 19/03 applied for the period 19 December 2019 to 31 December 2023. It was published in the *Tax Information Bulletin* Vol 32, No 2 in March 2020.
3. It is withdrawn on 14 July 2020.

Dinesh Gupta
Tax Counsel Lead, Tax Counsel Office

STANDARD PRACTICE STATEMENTS

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

SPS 20/04: Tax payments – when received in time

Introduction

This Statement sets out Inland Revenue's practice for accepting tax payments as having been received in time.

With the influence of technology there has been a significant shift in practice to use digital methods for making tax payments. The Commissioner encourages customers to use direct banking facilities when they make tax payments.

The table below outlines the payment options for customers, to make payments to Inland Revenue:

Payment options	You'll need
Online through your bank - PayTax function - Internet banking	IRD number Tax/product type or media number (from the return, letter or statement) Payment period (if applicable) Authorise the bank to make one-off or regular payments
Debit or Credit Card - Via myIR - On our secure payment website at **www.ird.govt.nz** and search 'make a payment' - On the phone using our 24/7 self-service (say 'make a payment') - On the phone with one of our staff (NZ business hours only)	Visa or Mastercard IRD number Tax/product type (if applicable) Payment period (if applicable)
Direct debit - via myIR - through your bank - on the phone with one of our staff	IRD number An authority for IR to initiate direct debit payments from your bank
Westpac in person - Counter services for cash or EFTPOS (you do not need to be a Westpac customer) - SmartATM for cash (all customers) - SmartATM EFTPOS (Westpac customers only)	From 1 July 2020, a barcode is required. The payment barcode can be found on your return, letter or IR statement - or create your own at **www.ird.govt.nz/barcode**
Through your bank - Automatic payment - Direct credit Both options allow for 2 people to sign	IRD number Tax/product type Payment period
By post - Cheque (by exception arrangement only)	Since 1 March 2020 we no longer accept cheques unless there is an exception arrangement in place. See 20 - 26

It is important to make your payments on or before the due date to avoid penalties or interest. If you are not able to pay on time, please contact Inland Revenue to discuss a possible instalment arrangement.

Application

This Statement applies from the date of signing. It replaces SPS 20/01 Tax payments – when received in time, which was published in *Tax Information Bulletin*, Vol 32, No 2 (March 2020).

Standard practice

Summary

1. This Statement sets out when Inland Revenue would accept payments as having been received in time, including:
    - electronic payments (from New Zealand)
    - debit/credit cards (Visa or Mastercard only)
    - cash and EFTPOS payments (accompanied by a barcode)
    - payments by cheque (with the prior agreement of the Commissioner)
    - tax pooling
    - tax transfers
    - overseas electronic payments
    - weekends and public holidays

Detailed discussion

2. This Statement applies to all tax types, as well as student loan repayments, small business Cash Loan payments and child support payments (payment of tax).

Electronic payments (from New Zealand)

3. Customers are encouraged to make payments electronically, including by internet banking. Payments by this method minimise delays and include formal notification of the date and time payment was made to Inland Revenue. A payment will be received in time when it has been electronically paid or direct credited into an Inland Revenue account either on or before the due date. To ensure payment is received in time, you need to be familiar with your banks' processing schedule.
4. A customer is able to future-date an electronic payment by using the "my tax payment" option available with all major New Zealand bank's internet banking service.
5. Customers who are registered for myIR can set up direct debits if there is an outstanding liability on the account, or if a return is filed at the same time (excluding for Multi Payment Option and Income Equalisation Schemes). Direct Debits cannot be set up for Child Support, KiwiSaver member and Tax Pooling. A direct debit payment will be received in time when the direct debit transaction is made on or before the New Zealand due date.

Debit/credit cards

6. Customers can make payment by using a (Visa or Mastercard only) debit/credit card over the phone to Inland Revenue, through the payment page on the IR website and through myIR, our secure online service.
7. A convenience fee of 1.42% is payable (charged by the banks) on all debit/credit card transactions from within New Zealand and overseas, with the exception of Child Support and Student Loan repayments from overseas, where Inland Revenue pays the convenience fee.
8. A debit/credit card payment will be received in time when it has been paid or direct credited into an Inland Revenue account on or before the New Zealand due date.

Cash and EFTPOS payments

9. Payments by cash or EFTPOS cannot be accepted over-the-counter at an Inland Revenue office. Westpac bank is authorised to receive over-the-counter payments on behalf of Inland Revenue.
10. Cash payments should not be sent by mail or courier to Inland Revenue.
11. Since 1 July 2020, payments at a Westpac branch or Smart ATM must either include a barcode obtained from letters, returns[1], and statements issued by Inland Revenue, or a barcode created through the Inland Revenue website[2] to provide clear payment instructions. A separate barcode is required for each individual tax type payable and tax period.

[1] While payment of tax may be made at Westpac branches, Westpac is not authorised to accept returns. Returns may be filed electronically, posted to Inland Revenue or delivered to an Inland Revenue office.

[2] Through Inland Revenues website payment page at **www.ird.govt.nz/make-a-payment/paying-at-westpac or www.ird.govt.nz/barcode**

12. Customers may pay by cash or EFTPOS at a Westpac counter or cash at a Westpac Smart ATM. Customers with a Westpac bank account may also pay via EFTPOS at a Westpac Smart ATM.
13. Payments made at a Westpac branch are received in time if they are made on or before the due date. The cut off time for a payment made at an ATM is 9PM, any payment made after this will go in the banking file on the next business day.

Tax pooling

14. Tax pooling involves customers depositing money with a tax pooling intermediary who then deposits that money into a tax pooling account with Inland Revenue. These deposits are not tax payments at this stage. When a payment is transferred from the tax pooling account into a taxpayer's tax account it becomes a tax payment.
15. The date of payment to Inland Revenue is triggered when the tax pooling deposit is transferred into a taxpayer's account. The effective date of the transfer can be no earlier than the date the tax pool deposit was received by Inland Revenue.
16. For more information on the implications of tax pooling see *Tax Information Bulletins*[5], Vol 15, No 5 (May 2003) pages 64 to 67, Vol 23, No 8 (October 2011) pages 35 to 55 and Vol. 29, No. 5 (June 2017) pages 148 to 149.

Overseas electronic payments

17. A payment will be received in time when it has been electronically paid or direct credited into an Inland Revenue account either on or before the New Zealand due date.
18. For more information about making payments from overseas visit **www.ird.govt.nz/makepayment/overseas/from-overseas-index.html**

Tax transfers

19. For the rules regarding the transfers of overpaid taxes refer to *Tax Information Bulletins*, Vol 14, No 11 (November 2002) pages 35 to 47, Vol 16, No 1 (February 2004) page 71 and Vol. 17, No. 1 (February 2005) pages 101 to 102.

Payments by cheque

20. Since 1 March 2020, Inland Revenue has not accepted cheques as a method for payment of tax. Customers are expected to use other bank services available for making payments.
21. The Commissioner may agree in exceptional circumstances for certain customers to make payment by cheque, where the customer can show they are unable to pay by any other means. Customers who consider that none of the other options for paying tax is difficult or impracticable for them should contact the Commissioner explaining why they cannot use one of the other options and so wish to continue to pay their tax using cheques. Each situation will be considered on a customer's individual circumstances.

Example 1

Alternative payment method available

Mary is 75 and lives in a remote area. She does not have access to the internet and there is no Westpac branch close by. Mary does have a landline and an EFTPOS card. After discussing Mary's situation with her, Mary agreed that she is able to set up a direct debit with us, or set up payments using an Automatic Payments form. On this basis, an exceptions arrangement to pay tax by cheque post 1 March 2020 was not approved.

Example 2

Agreed cheque exception arrangement

Jock lives in a remote rural area and lives off-the-grid. He does not have access to the internet or a reliable phone service and is many hours from any bank services. His only contact with Inland Revenue is through a Post Office box service from which he collects mail infrequently. The Commissioner would agree his circumstances are exceptional and that he may continue to pay tax by cheque post 1 March 2020.

22. A Requests for approval to continue paying by cheque can be made by telephone, SecureMail (log in to myIR), by post and at face to face appointments with Inland Revenue. It is important that requests for cheque exception arrangements made via myIR include customer phone contact details (where possible), should Inland Revenue want to further discuss alternative payment options with them. Customers that are unable to provide phone contact details will be sent a response via myIR (if registered) or by post.

Cheques through post

23. Where the Commissioner's agreement has been given to make cheque payments, cheques must be received on or before the due date irrespective of whether they are posted from within New Zealand or from overseas. Payments by post should be sent to: Inland Revenue, PO Box 39050, Wellington Mail Centre, Lower Hutt 5045.

24. Post-dated cheques have not been accepted as a payment method for tax since 1 March 2020. Post-dated cheques will be presented for payment on the day they are received by Inland Revenue where customers have prior agreement to pay by cheque.

25. Cheques will be returned to customers who have not obtained prior agreement from the Commissioner to pay by this method.

Physical delivery to Inland Revenue offices

26. Where the Commissioner's agreement has been given to make cheque payments, cheque payments will be accepted as being received in time if delivered to an Inland Revenue office on or before the close of business on the due date.

Income Equalisation Scheme (IES) deposits and primary sector business customers

27. Customers may make deposits via their online banking Pay Tax facility, by credit card and direct debit, as these tax types have been added into online banking as options for payment.

Weekends and public holidays

28. If a due date falls on a weekend or a public holiday, a payment will be in time when it is received at a Westpac branch or an Inland Revenue bank account on or before the next working day.

29. If a due date falls on a weekend or a public holiday (including a provincial anniversary day), and the Commissioner's agreement has been given to make cheque payments, cheque payments will be accepted as being received in time if received by an Inland Revenue office on or before the close of business on the next working day.

Provincial Anniversary Days

30. For those customers located in the province that is celebrating its anniversary day and who usually make tax payments in person over-the-counter at Westpac, the payment will be in time if received on or before the next working day.

This Standard Practice Statement is signed on 2 July 2020.

Rob Falk
National Advisor, Technical Standards - Legal Services

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 20/05: GOODS AND SERVICES TAX – SUPPLIES OF RESIDENCES AND OTHER REAL PROPERTY

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

Summary

1. This statement applies where a private residence is included as part of a wider supply of land. Where this occurs, s 5(15) deems the residence to be a separate supply from the rest of the land. The separate supplies need to be considered independently for GST purposes. This statement uses the term "residence" for the different types of premises mentioned in s 5(15).
2. Section 5(15) applies where a supply includes:
   - a principal place of residence; or
   - a supply referred to in s 14(1)(d).
3. "Principal place of residence" means premises occupied as the person's main residence. However, it does not have to be the vendor's own residence. It is the vendor's use of the property that is determinative, not the purchaser's intention. Section 14(1)(d) treats the sale of certain dwellings as an exempt supply, where the dwelling has been used exclusively for residential rental purposes for the preceding 5 years.
4. If a residence is included in a supply that includes other real property, s 5(15) deems there to be two (or more, if more than one residence is being supplied) separate supplies. A common example would be farm sales, where s 5(15) treats the farmhouse (provided it meets the definition of residence) and the rest of the farm as two separate supplies for GST purposes.
5. The separate supplies are treated individually for GST purposes. It is often assumed that the supply of the residence is exempt or non-taxable and the supply of the other real property is taxable and subject to GST. However, this is an oversimplification and the treatment depends on the facts:
   - A supply of a principal place of residence where the residence is used by the vendor in a taxable activity will be a taxable supply made in the course or furtherance of the taxable activity and subject to GST under s 8(1). The supply will be taxable at the standard rate or *may* be zero-rated if the compulsory zero-rating rules apply.
   - A supply of a principal place of residence where the residence is exclusively private in nature and is not used by the vendor in a taxable activity is not a taxable supply.
   - A supply of a principal place of residence which has been used solely by the vendor for making exempt supplies of residential rental accommodation is an exempt supply.
   - A supply referred to in s 14(1)(d) is an exempt supply.
   - A supply of the other real property used by the vendor in a taxable activity *may* be a zero-rated supply under the compulsory zero-rating rules or as a supply of a going concern.
6. Where s 5(15) applies so the supplies are considered individually for GST purposes, the consideration must be apportioned between the supplies. This enables the parties to identify the correct amount of GST payable on the transaction and to calculate any adjustments under ss 21–21H. To value the residence, it must be properly identified. For farmhouses, it may not be clear where the boundary of the farmhouse ends and where the farmland begins. When apportioning consideration between the two supplies, a farmhouse includes appurtenances (ie, things belonging to and used with the residence and included within its curtilage).

7. Any apportionment must reflect the respective values of the residence and the surrounding land. The onus of proof that an apportionment is fair and reasonable is on the person seeking to rely on the apportionment, whether that is the vendor or purchaser. A valuation may be needed to satisfy this onus. In cases of doubt or where there are significant amounts of consideration, the parties should obtain a valuation from a registered valuer.
8. When the supplier and recipient are GST registered, the same apportionment as set out in the tax invoice for any taxable supplies will apply to both parties. Ideally, this should be negotiated between the parties and agreed at the time of supply.
9. This statement updates and replaces IS2824 "GST – Supplies of dwellings and other real property" (*Tax Information Bulletin* Vol 8, No 6 (October 1996): 1), which dealt with the apportionment between, and the valuation of, supplies of dwellings and other real property for GST purposes. The principles applying to valuations in IS2824 remain largely unchanged.

Introduction

10. IS2824 was published in October 1996, shortly after subss 5(15)–(19) were enacted. The provisions were introduced in response to the Court of Appeal's decision in *CIR v Coveney* (1995) 17 NZTC 12,193 (CA) and to deal with an issue that arose under the former "principal purpose" rules.
11. Prior to the enactment of s 5(15), the Act did not have a provision for splitting a single supply that was partly taxable and partly non-taxable (or exempt) – such as where a private dwelling was acquired as part of the purchase of a farm. A GST input tax credit was allowed if the goods and services had been acquired for the "principal purpose" of making taxable supplies. Dwellings acquired as part of a wider purchase of land were an anomaly because often the principal purpose of the dwelling was non-taxable private use, but the purchase of the land as a whole would satisfy the principal purpose test.
12. The implementation of s 5(15) meant the supply of a dwelling was treated separately from the supply of the rest of the land. It would not give rise to an input tax deduction unless the dwelling itself had been acquired for the principal purpose of making taxable supplies. Subsections 5(15)–(19) essentially reversed the Coveney decision and are consistent with the Commissioner's position before the Coveney decision. Another effect was that the dwelling and other real property must be valued separately.
13. Since IS2824 was published there have been numerous changes to the legislation, including the removal of the principal purpose rule for assets acquired after 1 April 2011. This statement discusses how the current s 5(15) and related provisions apply.

Application of subss 5(15), (16) and (18)

14. Subsections 5(15), (16) and (18) state:

> (15) When either of the following supplies are included in a supply, they are deemed to be a separate supply from the supply of any other real property that is included in the supply:
>
> (a) a supply of a principal place of residence:
>
> (b) a supply referred to in section 14(1)(d).
>
> (16) Where a registered person has claimed a deduction in accordance with section 20(3) in respect of the supply of a dwelling, any subsequent supply by the registered person of—
>
> (a) the dwelling; or
>
> (b) any land or other part of the dwelling that has ceased or will by reason of the supply cease to be appurtenant to or enjoyed with the dwelling,—
>
> will, for the avoidance of doubt but subject to subsections (17), (18), and (19)(b), be deemed to be a taxable supply.
>
> …
>
> (18) Where a registered person has claimed a deduction in accordance with section 20(3) in respect of a proportion of a dwelling, the supply of that dwelling shall be deemed to be a taxable supply only to the extent that the proportion claimed bears to the whole dwelling

15. Subsections 5(15)–(19) were a suite of provisions introduced specifically to deal with Coveney-type situations where a person could take advantage of the old principal purpose rule to claim GST input tax for a dwelling (which would otherwise be exempt or non-taxable). The purpose of subss 5(16) and (18) was to collect GST output tax from those who had already claimed a pre-s 5(15) input tax deduction.
16. Section 5(15) can apply to a residence where there is the supply of other real property included in the supply. The word "other" requires a different or another item of real property distinct from the residence referred to. Where s 5(15) applies, the vendor will need to treat the two (or more) supplies as separate for GST purposes.

17. Section 5(16) provides that where a person has claimed GST for a dwelling, any subsequent supply will be deemed taxable. This is subject to s 5(18), which restricts the deemed taxable supply to the proportion of GST input tax claimed. These provisions were part of the legislative response to the *Coveney* decision. The taxpayers in *Coveney* had claimed a GST input tax deduction for their dwelling because it was part of a wider supply. Subsections 5(16) and (18) ensured that taxpayers in this position will be liable for GST output tax on disposal of the dwelling. Under the previous principal purpose approach, if the dwelling was subsequently supplied separately it would likely be a non-taxable supply. This is because a dwelling is not likely to be used principally for making taxable supplies and so the supply of the dwelling would not be in the course or furtherance of a taxable activity under s 8(1). Consequently, subss 5(16) and (18) were required to deem a subsequent supply of the dwelling as a taxable supply. With the passage of time these provisions are likely to only be relevant to a small number of taxpayers.

18. Subsections 5(17) and (19)(b) were exceptions to s 5(16). These provisions effectively allowed a person to otherwise account for the GST they had claimed on their dwelling. Section 5(17) has been repealed and s 5(19) only applies where a person made an election before 1 August 1996. Consequently, these provisions are not discussed in this statement.

Amendments to s 5(15)

19. When first enacted in 1995, s 5(15) referred to "a dwelling":

> (15) Where a dwelling is included in a supply, the supply of that dwelling is deemed to be a separate supply from the supply of any other real property included in the supply

20. Since 1995 there have been the following relevant changes:

- The Taxation (GST and Remedial Matters) Act 2010 amended:
  - s 5(15) so the phrase "principal place of residence" replaced the word "dwelling" and a new definition of "principal place of residence" was added to s 2; and
  - the definition of "dwelling" in s 2(1) (see appendix) was amended to change it from a wide definition focused on the nature of the building to a narrower definition based on the nature of the supply.
- Before the 2010 version of s 5(15) came into effect it was amended by the Taxation (Tax Administration and Remedial Matters) Act 2011. The 2011 amendments included the:
  - addition of clause (b); and
  - removal of the reference to s 5(15) in the definition of "principal place of residence".
- From 1 April 2011, the apportionment and adjustment rules changed so that deductions are now based on the use (or intended use) of the asset in making taxable supplies, rather than the former principal purpose test.

21. The changes to the legislation have been significant but s 5(15) still largely operates in the same way. For example, if a farm sale includes a farmhouse (used as a residence), then there will be two separate supplies.

Application of s 5(15)

22. Section 5(15) applies to either a supply of:

- a principal place of residence; or
- a dwelling to the extent it is a supply referred to in s 14(1)(d).

Principal place of residence

23. "Principal place of residence" is a term that can have slightly different meanings depending on the context. In the definition of "dwelling" the phrase "principal place of residence" is intended to mean premises supplied as accommodation to a person who occupies them as their main residence for the duration of an agreement. In the context of the zero-rating provisions, the "principal place of residence" is intended to indicate land used by its owner or their relatives as their main place of residence.

24. References to specific provisions (including s 5(15)) in the previous s 2 definition of "principal place of residence" were removed to avoid confusion about when the different meanings apply. "Principal place of residence" is now defined only for the purposes of "dwelling":

> **principal place of residence**, in the definition of **dwelling** means a place that a person occupies as their main residence for the period to which the agreement for the supply of accommodation relates

25. The Commissioner discussed the term in IS 17/08: "GST – Compulsory zero-rating of land rules (general application)" (*Tax Information Bulletin* Vol 29, No 10 (November 2017): 17) and considered:
    - The phrase "principal place of residence" in s 5(15)(a) refers to a place occupied as a person's main residence. The plain meaning of the phrase indicates a person may have more than one residence, but at any point in time they can have only one **main** residence.
    - Because the provision refers to a person's main residence, the application of s 5(15)(a) is not restricted to a place occupied as the vendor's main residence. It is possible for a vendor to supply a principal place of residence that is not their own residence (eg, a house that has been lived in by a farm manager).
    - Section 5(15)(a) is concerned with the supply of a principal place of residence. Therefore, for the purposes of s 5(15), the current use of the property is determinative rather than the purchaser's intended use of the property. This is in contrast to how the phrase is used in the compulsory zero-rating rules, which focuses on the purchaser's (or their relative's) intended use of the land.
    - The inquiry in s 5(15)(a) is objective, based on the available information.
26. "Principal place of residence" as used in s 5(15) is different from the term "dwelling" used in previous versions of s 5(15). While the changes in terminology can be confusing, where a person occupies a residential property as their home it will usually be both a "dwelling" and a "principal place of residence". That said, there are some differences in the definitions; notably a "dwelling" will usually require quiet enjoyment as that term is used in s 38 of the Residential Tenancies Act 1986 and does not include a property that is a "commercial dwelling" (defined in s 2 of the Act). These differences mean there will be some exceptions where a property is a principal place of residence but not a dwelling. By using the phrase "principal place of residence" and not "dwelling", s 5(15)(a) will apply to properties such as homestays (a commercial dwelling in the s 2 definition) provided the property is a person's principal place of residence.
27. Whether a property is a "principal place of residence" will be a matter of fact. For example, a farmhouse supplied to sharemilkers will likely be a principal place of residence (and it could also be a supply of a dwelling under s 14(1)(d)). Conversely, where farm lodgings are supplied to fencing contractors for the duration of their job, this is not the supply of a principal place of residence. The contractors only stay in the property for a relatively short period because it is not convenient to travel back to their homes in town. Similarly, a property exclusively rented out as farmstay accommodation on a peer-to-peer website will be used as short-stay holiday accommodation and the guests will not be using the property as their principal place of residence. Consequently, s 5(15)(a) will not apply to deem a separate supply of such a property.

Supply within s 14(1)(d)

28. This provision treats the sale of a dwelling that has been **used exclusively** for making exempt supplies of residential rental accommodation for the preceding 5 years, as an exempt supply. The dwelling can have been supplied as residential rental accommodation by way of hire, a service occupancy agreement or a licence to occupy. However, it still must be a supply of a "dwelling" (as defined in s 2), which means, amongst other things, it must be a person's "principal place of residence" (as defined in s 2).
29. Section 14(1)(d) is discussed in detail in IS 07/01: "GST treatment of sale of long-term residential rental properties" (*Tax information Bulletin* Vol 19, No 5 (June 2007): 16). There have been a number of changes to the GST Act since IS 07/01 was published (see [20]), however some of the analysis remains relevant, in particular s 14(1)(d):
    - applies where the property is used for residential purposes and for no other purpose for the required period;
    - can apply even if the property is vacant for periods during the 5 years (eg, while attempts are made to find a tenant); and
    - only applies where the vendor uses the property for residential purposes for 5 years. It does not apply where different owners have rented the property out over a 5-year period.

Summary

30. Section 5(15) applies where a supply includes a principal place of residence or a supply within s 14(1)(d). When considering this issue, the focus is on the vendor's use of the property rather than the purchaser's intended use. Section 5(15) can apply to both owner-occupied homes and rental properties.

GST on the separate supplies

31. If s 5(15) deems there to be two or more separate supplies, then each supply is considered individually. The supply of the residence is most likely an exempt or non-taxable supply and the supply of the other real property is likely subject to GST.

However, this is not always the case. For example, the supply of the residence may be subject to GST under s 8(1) because it is a supply in the course or furtherance of a taxable activity, and the supply of the other real property may be zero-rated. In some cases, the separate supplies may be subject to the same GST treatment (eg, both supplies are taxable under s 8(1)).

32. Section 5(15) applies whenever a principal place of residence is supplied with other real property. A common example of s 5(15) applying is to farm sales where the farmhouse (provided it is a residence) is treated as a separate supply from the rest of the farm. It will also apply in other situations, such as where there are residential flats above a commercial property. Section 5(15) can also apply where there are two houses on a single property and one house is used as a principal place of residence and one is not. For example, a registered person lives in the main house but has a separate cottage on their property that they use solely for their taxable activity of making taxable supplies of short-stay accommodation via a peer-to-peer website. Where s 5(15) applies, the vendor needs to treat the two supplies as separate. The next section of the statement considers the treatment of the separate supplies.

Supplies of a principal place of residence

33. The supply of a principal place of residence will usually be a non-taxable supply and not subject to GST because it is a supply of a private home. It will not generally form part of a registered person's taxable activity. However, where a principal place of residence is used in a registered person's taxable activity, then the supply is chargeable with GST under s 8(1), at either the standard rate or zero rate.

34. Section 8(1) imposes GST output tax when the supply is in the **course or furtherance of a taxable activity**. As noted, a residence is usually used as a private home and so any separate supply of that residence will not usually be in the course or furtherance of a taxable activity. However, s 8 may apply where the residence being supplied is used as part of a business. Accordingly, it is necessary to consider whether a supply of a residence in such circumstances will be in the course or furtherance of a taxable activity.

35. Case law supports the view that "in the course or furtherance of a taxable activity" can include the one-off sale of capital items that a registered person uses in their taxable activity (*Case K55* (1988) 10 NZTC 453, *Hibell v CIR* (1991) 13 NZTC 8,195 (HC) and *CIR v Dormer* (1997) 18 NZTC 13,446 (HC)). Further, the property supplied does not need to be the "usual" good supplied by the taxpayer for it to come within the scope of the taxpayer's taxable activity (*Case K55*, *Case N43* (1991) 13 NZTC 3,361 and *Case V16* (2002) 20 NZTC 10,182). Whether property comes within the scope of a taxable activity is a matter of fact and will depend on the "use" or "involvement" of the property in the taxable activity (*Case V16*, *Case K55*). In *Case K55*, this was characterised as there being a "discernible nexus" between the activity and the supply.

36. IS 20/04 *GST treatment of short-stay accommodation* (Inland Revenue, June 2020) discusses whether a disposal will be "in the course or furtherance" of a person's taxable activity of supplying short-stay accommodation. That item contains a more detailed discussion of the term "course or furtherance" but, in short, a supply of a residence can be in the course or furtherance of a taxable activity even though it is a one-off sale and not the usual type of good supplied by the person. In the short-stay accommodation context, if a property is used to make taxable supplies of short-stay accommodation, the subsequent disposal of the property will be in the course or furtherance of the taxable activity and subject to GST output tax under s 8(1) (and potentially subject to an adjustment under s 21F if there has been both taxable and non-taxable use).

37. Whether a supply is within the scope of s 8(1) will ultimately be a question of fact based on the use of the residence. For example, if a farmhouse is not used in a taxable activity, s 8(1) will not apply. On the other hand, if a GST-registered farmer is claiming an automatic 20% deduction for farmhouse expenses based on IS 17/02: "Income tax – deductibility of certain expenses attributable to a farm dwelling" (*Tax information Bulletin* Vol 29, No 4 (May 2017): 82) then there is an expectation that the property is being used 20% of the time in the taxable activity. Consequently, any sale of the farmhouse would be a supply in the course or furtherance of the taxable activity and subject to GST under s 8(1) (with an adjustment available under s 21F).

Supplies under s 14(1)(d)

38. A supply of a residence under s 14(1)(d) will be an exempt supply and will not be subject to GST.

Zero-rating rules

39. The zero-rating rules may apply to one or more of the separate supplies created by s 5(15). Section 11(1)(mb) provides for compulsory zero-rating where:

- both the supplier and recipient are GST-registered;
- the property will be used to make taxable supplies; and
- it will not be lived in as a principal place of residence by the recipient or their relatives.

40. An example where the compulsory zero-rating (CZR) rules might apply, is where a registered person sells their property comprising their home and a cottage used solely to supply short-stay accommodation on a peer-to-peer website. In that situation, s 5(15) deems there to be a supply of the registered person's home, and a separate supply of the cottage. If the sale is to a GST-registered purchaser who does not intend to reside in the cottage and will continue supplying short-stay accommodation, that supply may be zero-rated under s 11(1)(mb). For further detail on the application of the CZR rules refer to IS 17/08: "GST – Compulsory zero-rating of land rules (general application)" (*Tax Information Bulletin* Vol 29, No 10 (November 2017): 17).

41. On the sale of a farm between registered persons it is likely that the sale of the farm will meet the requirements of the CZR rules and be zero-rated. However, the supply of a farmhouse is less likely to meet the requirements as it will not necessarily be used to make taxable supplies (see above) but in any event, it may be used as a principal place of residence by the recipient or their relatives. If the CZR rules do not apply to the farmhouse, then it is likely to be either:

- a standard rated supply, if used in the taxable activity; or
- not subject to GST if used to make exempt supplies or not otherwise used in the taxable activity.

42. In some circumstances, a transaction can be zero-rated under s 11(1)(m) where a taxable activity is sold as a going concern. Unlike the CZR rules, the parties may choose whether to zero-rate the supply of a going concern. The interaction of the going concern rule and the CZR rules is also discussed in IS 17/08.

Apportionment and valuation issues

43. When s 5(15) applies, the vendor will be making two or more supplies. Depending on the circumstances those supplies will be taxable, non-taxable or exempt.

Identifying the residence

44. To value the residence and apportion the purchase price between the supplies, the extent of the principal place of residence must be identified. In the case of farmhouses this can be difficult because the land and buildings belonging to the farmhouse are not always clearly delineated from the rest of the farm. For other types of property (like flats above business premises) the residence might include rights to use common areas. The Commissioner considers it is reasonable for the purposes of s 5(15) that a principal place of residence also includes any appurtenances belonging to or used with it. While the phrase "principal place of residence" is not defined in the GST Act for the purposes of s 5(15), including appurtenances with a residence is consistent with the definition of "dwelling" in s 2(1), and in particular with para (b)(ii) of the definition that provides that a dwelling includes "any appurtenances belonging to or used with the premises".

45. The meaning of "appurtenances" in the context of the Act was considered in *Norfolk Apartments Ltd v CIR* (1995) 17 NZTC 12,212 (CA) and briefly in *Wairakei Court Ltd v CIR* (1999) 19 NZTC 15,202 (HC) (both cases concerned retirement villages). These cases and the term "appurtenance" are discussed in detail in IS 15/02: "Goods and services tax – GST and retirement villages" (*Tax Information Bulletin* Vol 27, No 11 (December 2015): 6). While IS 15/02 deals with retirement villages, the underlying principles apply to all properties.

46. The Court of Appeal in *Norfolk* refers to the English authorities (*Methuen-Campbell v Walters* [1979] 1 All ER 606 and *Trim v Sturminster Urban District Council* [1938] 2 All ER 168). The *Trim* case considered the word "appurtenances" in a statutory definition of "house". It held that it has its natural meaning and could not extend to cover land outside the curtilage of the house. Farmland adjacent to the house was not an appurtenance. In *Methuen-Campbell* the issue was whether a paddock adjoining the garden of a dwelling-house was within the curtilage and an appurtenance to the house. A fence separated the paddock from the garden, although access had once been available through a now boarded-up gate in the fence. The Court considered the *Oxford English Dictionary* definition of curtilage as "a small court, yard, or piece of ground attached to a dwellinghouse and forming one enclosure with it" and considered what is within the curtilage is a question of fact in each case. In that case the paddock did not form part of the curtilage, being well apart from the house and physically separated from the garden.

47. IS 17/02: "Income tax – deductibility of certain expenses attributable to a farm dwelling" (*Tax information Bulletin* Vol 29, No 4 (May 2017):82) discussed the identification of "curtilage" in the context of farmhouses:

> 98. The term "curtilage" refers to the land surrounding the farmhouse that is used primarily for private purposes. The curtilage may be fenced (like a backyard) or not. If the curtilage is not fenced, the Commissioner will accept a reasonable estimate of the curtilage and its value. The curtilage must be taken into account when determining the value of the farmhouse as a proportion of the overall value of the farm. This is because the curtilage is generally used for private purposes and is not used in the farming business. The extent of the curtilage, and its value, must be measured on a fair and reasonable basis. The Commissioner will accept a valuation,

> a reasonable estimate of the value of the curtilage, or an apportionment based on land area (ie, on a value/cost per hectare basis). Any apportionment needs to be calculated on a reasonable basis and recognise the land value of the curtilage will often be proportionately higher than the rest of the farm.

48. Whether land or buildings are appurtenant to a house and contained within its curtilage is based on both physical aspects (ie, proximity to the house and separation from the house) and also on the use to which the land or buildings are put. Something will be an appurtenance where its use and enjoyment forms part of the use and enjoyment of the residence and where it belongs to the residence so that it is not physically separated from the dwelling (eg, by distance or by a fence or a hedge). To determine the extent of a principal place of residence, the facts of each case need to be examined to work out the physical area and any other rights reasonably belonging to and used with the residence.

49. For example, a landscaped garden surrounding a residence that includes a swimming pool and tennis court will be appurtenant to the residence and within its curtilage. While the pool and tennis court may be fenced for safety reasons they are still within the residence's curtilage, belong to and are used as part of the use of the residence. However, a fenced horse paddock, (such as in *Methuen-Campbell*), is not appurtenant to a residence as it is physically separated from the residence, so it does not "belong" to the residence and it is not used as part of using the residence. It is not within the residence's curtilage.

Tax invoices

50. The tax invoice for any taxable supplies made by the vendor should state the consideration for those taxable supplies and the amount of tax charged or included in the consideration (see s 24(3)). If the parties have not agreed the separate consideration for the taxable supplies, the total consideration for the whole transaction will need to be apportioned between the taxable supplies and the other non-taxable or exempt supplies.

Valuation

51. Where the consideration needs to be apportioned between the separate supplies the onus of proof that the apportionment and the method adopted to reach that apportionment are fair and reasonable in the circumstances, is on the party seeking to rely on the apportionment.

52. Section 10(18) states that if a taxable supply is not the only matter to which a consideration relates, the supply is deemed to be for such part of the consideration as is properly attributable to it.

53. While s 10(18) refers to the amount of consideration that is properly attributable to the supply, s 3A(3)(d) limits the GST input tax claimable to the lesser of the tax fraction of the purchase price or the tax fraction of the open market value of the supply. This may apply in s 5(15) situations where the purchaser claims a secondhand goods GST input tax deduction on a non-taxable supply. For example, where the sale of the residence is non-taxable (because the vendor only uses it privately and not in their taxable activity) and the purchaser subsequently claims a secondhand goods GST input tax deduction (because the purchaser intends to use the residence for taxable purposes). The amount of the GST input tax deduction is limited to the lesser of the tax fraction of the purchase price or open market value. Where open market value is lower, or there is no agreed apportionment of the purchase price, the open-market value will be the default.

54. Hansen J briefly considered s 10(18) in *Auckland Institute of Studies Ltd v CIR* (2002) 20 NZTC 17,685. He found there was no separate supply and so it was unnecessary to consider the value of those zero-rated supplies. However, he went on to make the following obiter comments:

> [67] As concluded in the Smiths City case (para 25 above), s 10(18) of the Act suggests that the value of a separate supply is what is "properly attributable" to it. Other provisions of the Act indicate that the **open market value of the service is an appropriate basis on which to fix value**.
>
> Section 4(2) provides:
>
> > "For the purposes of this Act, the open market value of any supply of goods and services at any date shall be the consideration in money which the supply of those goods and services would generally fetch if supplied in similar circumstances at that date in New Zealand, being a supply freely offered and made between persons who are not associated persons."
>
> Section 10(2)(b) provides:
>
> > "Subject to this section, the value of a supply of goods and services shall be such amount as, with the addition of the tax charged, is equal to the aggregate of:
> >
> > …
> >
> > (b) To the extent that the consideration for the supply is not consideration in money, the open market value of that consideration."

> [68] When it is possible, I see no reason why values should not initially be assessed on the basis of the actual cost of providing the separate supply, plus a reasonable allowance for profit. In this case that would not be possible as agents are remunerated by a commission which itself would have to be apportioned between marketing and promotional services provided to the [sic] International and services provided solely or in part to the students. However, ultimately, **the appropriate value for a separate supply would have to be tested against the market**. I accept Mr Willox's submission that the value of a separate supply could not exceed the sum which a hypothetical consumer would be prepared to pay.
>
> [Emphasis added]

55. Sections 10(18) and 3A(3)(d), and Hansen J's comments in *Auckland Institute* (although obiter) support the view that the amount paid for a residence and other real property supplied together should be the amount properly attributable to each supply, being the open market value. Where GST-registered non-associated parties agree the purchase price through negotiations, there is an assumption that this will be the open market value. Where the parties are associated, then subs 3A(3)(a)–(c) limit the GST input tax, often to the lesser of input tax on the purchase price or open market value. However, the onus of proof that an apportionment is correct is on the person seeking to rely on the apportionment. Even when the purchase price is agreed, obtaining a valuation to support apportionment should be considered, particularly in cases of doubt or involving significant amounts of consideration.
56. A valuation may be necessary to identify the market value when:
    - a GST-registered vendor and purchaser cannot agree on the respective values of the residence and the other real property; or
    - a GST-registered vendor needs to issue a tax invoice and the sale and purchase agreement does not apportion the consideration.
57. Even where no GST is payable on the transaction (eg, where the supply of the residence is non-taxable and the other real property is subject to the CZR rules), a valuation of the separate supplies is still necessary. For instance, the CZR rules require that:
    - the vendor keeps certain records including details of the consideration received for the supply (see s 75(3B)); and
    - the purchaser identifies the nominal amount of GST chargeable on the supply (ie, the GST if the transaction was not zero-rated) (see s 20(3J)).
58. Moreover, either party may need to value the separate supplies so they can calculate adjustments required under ss 21–21H. For instance, in the case of a farm sale, there might be future change-of-use adjustments if the purchaser plans to use the farmhouse for making taxable supplies.
59. The method of valuation depends on the circumstances of the case. The method adopted should best reflect the market value of the property in the circumstances. For example, an apportionment based solely on land area is unlikely to be acceptable if it is reasonable for the value of the residential land to be proportionately higher than the rest of the land. This can be the case with farms – see IS 17/02 (at [47]). For farms, sometimes it may be more reasonable to value the residence by comparison with sales of residential properties in nearby rural townships, than by applying the per hectare farmland valuation across the board. Ultimately, the onus is on the taxpayer to demonstrate they have used a fair and reasonable basis for their apportionment in the circumstances.
60. A supply forming part of a larger transaction should not be over or under-valued at the expense of another supply in the same transaction. Valuations should be applied to the total consideration on a pro-rata basis. This might be relevant where separate valuations are obtained for separate supplies or if a valuation does not align with the actual purchase price. More information on applying valuations on a pro-rata basis is provided in QB 09/06: "GST – Apportionment of the cost of bare land for the purposes of a change-in-use adjustment" (*Tax Information Bulletin*, Vol 22, No 6, (July 2010: 21)).
61. Ideally, a valuation should be made by a registered valuer and any valuation relied upon needs to identify the method of valuation and reasons for adopting that method. In cases of doubt or significant consideration, Inland Revenue may insist on a valuation by a registered valuer. If registered persons are in doubt as to whether they need to obtain a valuation from a registered valuer, they should contact their tax adviser.

Examples

62. The following examples are included to assist in explaining the application of the law. Example 1 is adapted and updated from the example in IS2824.

Example 1 - Sale of farm with two farmhouses

The properties

A GST-registered farmer negotiates to sell a 225-hectare farm that includes two farmhouses.

The farmer and his family occupy the main farmhouse. A fenced garden area of 4,000 square metres surrounds the farmhouse that includes a chicken coop, the vegetable garden and various small sheds. There is an adjacent paddock of 5,000 square metres, known as the "home paddock".

Farm employees and their families occupy the second farmhouse (and it has been rented to various employees and their families for more than 5 years). It is fenced on two sides, has a hedge on one side and a stream running along the fourth side. The area within these boundaries measures 4,750 square metres. The area includes a garage, a mower shed, a few trees and a washing line. There is no garden.

The application of s 5(15)

Section 5(15) applies to the supply of the farm property. It deems the supply of each of the residences and the balance of the farmland and buildings to be separate supplies. This is because the two farmhouses are the principal places of residence of the families that live in them. The second farmhouse is also a supply subject to s 14(1)(d).

For the main farmhouse, this is used by the farmer in the farming operations. Following IS 17/02: "Income tax – deductibility of certain expenses attributable to a farm dwelling", the farmer has been claiming 20% of the expenses relating to the property for income tax purposes – as well as claiming GST input tax on these expenses. On this basis, the farmhouse is used in the farmer's taxable activity and is subject to GST under s 8(1) on sale (with an adjustment under s 21F).

The second farmhouse has at various times been rented or made available under a service occupancy agreement to farm employees. This means that the second farmhouse has been used for making exempt supplies and so no GST input tax was claimable on it. As it was used for making exempt supplies, it is excluded from forming part of the farmer's taxable activity under s 6(3)(d). In any event, it would be an exempt supply under s 14(1)(d). Therefore, the second farmhouse is not subject to GST on sale.

Identifying the extent of the properties

The physical area of the residence in each case is as follows:

- Main farmhouse — 4,000 square metres. The home paddock is not part of the curtilage of the farmhouse. The area is physically divided off from the farmhouse. It is reasonable to treat the fenced area immediately surrounding the farmhouse as its curtilage.
- Second farmhouse — 4,750 square metres. Although fairly large, it is reasonable to treat this area as appurtenant to the farmhouse. This area is physically divided off from the surrounding farmland by both artificial and natural features.

Valuation and apportionment of purchase price

Anticipating selling the property, the farmer has recently had the farm independently valued by a registered valuer. he valuation (exclusive of GST) shows:

- Farmland and farm improvements – $1.4 million
- Main farmhouse – $250,000
- Second farmhouse – $200,000
- Total value = $1.95 million

The farmer negotiates to sell the farm for $2 million plus GST, to a GST-registered purchaser who is acquiring the farm to carry on a taxable activity of farming. The parties are not treating this as the sale of a going concern, however the CZR rules will apply to the supply of the farm (but not the farmhouses).

In finalising the terms of the sale and purchase agreement, the parties agree that the purchase price shall be apportioned between the farm as to $1.5 million and the two farmhouses as to $500,000. The split between the two farmhouses is agreed as being $300,000 for the main farmhouse and $200,000 for the second farmhouse. (The purchaser is prepared to accept this price and the apportionment, having received their own valuation.)

The sale and purchase agreement includes the following details:

- Apportionment of consideration:
  - Farm – $1.5 million (plus GST of $0 as zero-rated)
  - Main farmhouse – $300,000 (plus GST of $45,000 as standard rated)
  - Second farmhouse - $200,000 (plus no GST as exempt)
- Total price including GST – $2,045,000

GST output tax of $45,000 is payable on the transaction, with an adjustment made under s 21F for GST input tax not claimed on the main farmhouse. GST input tax may be claimable by the purchaser on the main farmhouse to the extent that it is used in their taxable activity, and the CZR rules require them to identify the nominal amount of GST on the farm – in this case $225,000 ($1.5 million × 15%).

Example 2 - Sale of section with home and holiday cottage

Petunia and Vernon own a section next to Lake Wakatipu. On the section is a three-bedroom house and a separate holiday cottage. The house is used solely as their private residence. The holiday cottage is accessed via a private driveway. It has a white picket fence on three sides and drops away to the lake on the other side. The cottage is used as a dedicated short-stay rental property. It is well maintained, in a prime location and is advertised on various websites. It is used year-round by skiers, trampers and overseas holiday makers. The holiday cottage's turnover is $70,000 a year and so Petunia and Vernon are registered for GST.

Petunia and Vernon told an estate agent friend that they were thinking of retiring and their friend told them they could get $2 million for the property in the current market. They mentioned this to Luna who has previously shown an interest in the property. The parties are interested but want to know the GST implications before they go any further.

The Act treats the supply of a principal place of residence and other property as separate supplies. The three-bedroom house is used by Petunia and Vernon as their principal place of residence and so is treated separately from the holiday cottage for GST purposes.

The three-bedroom house is not used in the taxable activity and will not be subject to GST output tax when sold. There may be GST implications in the future if Luna decided to also use the house to make supplies of accommodation. However, on sale there is no GST output tax liability for Petunia and Vernon.

The holiday cottage is used in the taxable activity to make taxable supplies and will be subject to GST output tax. If Luna remains unregistered (because she intends to make fewer supplies and stay below the $60,000 threshold) then GST would be payable at the standard rate. However, it is more likely that Luna will be GST registered in which case the compulsory zero-rating rules may apply. GST will apply at 0% if the holiday cottage will be used to make taxable supplies and it will not be lived in as a principal place of residence by Luna or her relatives.

In many cases prudent parties (or their lenders) will require a valuation from a registered valuer. In this case they decide they will want a valuation. This is a good idea because even though they do not return any GST there are still record keeping requirements on Petunia and Vernon. Luna is also required to identify the nominal amount of GST chargeable on the supply of the holiday cottage (ie, the GST if the transaction was not zero-rated). Moreover, the valuations could be important for Luna if her use of either property changes and she is required to calculate change in use adjustments.

Example 3 – Sale of shop and flat

Rita is selling a giftshop she has owned and operated for the last ten years. Above the giftshop is a two-bedroom flat with a separate accessway. When she first purchased the property, she lived in the flat but for the last 8 years she has rented it out to tenants.

Rita is GST registered and is selling the business and property to a GST registered purchaser who will continue to operate the giftshop.

Section 5(15) will apply to split the supplies – the giftshop and the two-bedroom flat. The GST treatment of these supplies is as follows:

- The supply of the giftshop will be subject to GST but at 0% because the compulsory zero-rating rules will apply. This is because the parties are both GST-registered and the purchaser is intending to continue to make taxable supplies.
- The supply of the flat is not subject to GST as it does not form part of Rita's taxable activity.

References

Subject references

GST

Supplies of residences

Apportionment

Legislative references

Goods and Services Tax Act 1985, ss 2 ("dwelling", "principal place of residence", "commercial dwelling"), 3A(3), 5(15)–(19), 8(1), 10(18), 11(1)(m), 11(1)(mb), 14(1)(d), 20, 21, 21F, 21G, 21H, 24(3), 75(3B)

Residential Tenancies Act 1986

Taxation (GST and Remedial Matters) Act 2010

Taxation (Tax Administration and Remedial Matters) Act 2011

Case references

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

Case K55 (1988) 10 NZTC 453

Case M64 (1990) 12 NZTC 2,363

Case N43 (1991) 13 NZTC 3,361

Case V16 (2002) 20 NZTC 10,182

CIR v Coveney (1995) 17 NZTC 12,193 (CA)

CIR v Dormer (1997) 18 NZTC 13,446 (HC)

English Clays v Plymouth Corporation [1974] 2 All ER 239 (CA)

Hibell v CIR (1991) 13 NZTC 8,195 (HC)

Lister v Pickford (1865) 34 Beav 576

Methuen-Campbell v Walters [1979] 1 All ER 606

Norfolk Apartments Ltd v CIR (1995) 17 NZTC 12,212 (CA)

Re Red Lion Inn Ltd [1979] 2 NZLR 668 (SC)

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Wairakei Court Ltd v CIR (1999) 19 NZTC 15,202

Other references

IS 20/04 GST treatment of short-stay accommodation (Inland Revenue, June 2020)

IS 17/08: "Goods and services tax – Compulsory zero-rating of land rules", *Tax Information Bulletin* Vol 29, No 10 (November 2017): 17

IS 17/02: "Income tax – deductibility of certain expenses attributable to a farm dwelling", *Tax information Bulletin* Vol 29, No 4 (May 2017): 82

IS 15/02: "Goods and services tax – GST and retirement villages", *Tax Information Bulletin* Vol 27, No 11 (December 2015): 6

IS 07/01 "GST treatment of sale of long-term residential rental properties", *Tax information Bulletin* Vol 19, No 5 (June 2007): 16

IS2824 "GST – Supplies of dwellings and other real property", *Tax Information Bulletin* Vol 8, No 6 (October 1996): 1

QB 09/06: "GST – Apportionment of the cost of bare land for the purposes of a change-in-use adjustment" (*Tax Information Bulletin*, Vol 22, No 6, (July 2010): 21

Shorter Oxford English Dictionary on Historical Principles, 6th ed, Oxford University Press, New York, 2007.

Appendix – Legislation

Goods and Services Tax Act 1985

1. Section 2(1) definitions, relevantly include:

dwelling, for a person—

(a) means premises, as defined in section 2 of the Residential Tenancies Act 1986,—

(i) that the person occupies, or that it can reasonably be foreseen that the person will occupy, as their principal place of residence; and

(ii) in relation to which the person has quiet enjoyment, as that term is used in section 38 of the Residential Tenancies Act 1986; and

(b) includes—

(i) accommodation provided to a person who is occupying the same premises, or part of the same premises, as the supplier of the accommodation and who meets the requirements of paragraph (a)(i):

(ii) any appurtenances belonging to or used with the premises:

(iii) despite paragraph (a)(ii), a residential unit in a retirement village or rest home when the consideration paid or payable for the supply of accommodation in the unit is for the right to occupy the unit; and

(c) excludes a commercial dwelling

commercial dwelling—

(a) means—

(i) a hotel, motel, homestay, farmstay, bed and breakfast establishment, inn, hostel, or boarding-house:

(ii) a serviced apartment managed or operated by a third party for which services in addition to the supply of accommodation are provided and in relation to which a resident does not have quiet enjoyment, as that term is used in section 38 of the Residential Tenancies Act 1986:

(iii) a convalescent home, nursing home, rest home, or hospice:
(iv) a camping ground:
(v) premises of a similar kind to those referred to in subparagraphs (i) to (iv); and
(b) excludes—
(i) a hospital except to the extent to which the hospital is a residential establishment:
(ii) a dwelling referred to in paragraph (b)(iii) of the definition of dwelling

2. Section 3A(3)(d), relevantly states:

3A Meaning of input tax

(1) Input tax, in relation to a registered person, means—
(a) tax charged under section 8(1) on a supply of goods or services acquired by the person:
(b) tax levied under section 12(1) on goods entered for home consumption under the Customs and Excise Act 2018 by the person:
(c) an amount determined under subsection (3) after applying subsection (2).

(2) In the case of a supply by way of sale to a registered person of secondhand goods situated in New Zealand, the amount of input tax is determined under subsection (3) if—
(a) the supply is not a taxable supply; and
(b) the supply is not—
(i) a supply of goods previously supplied to a registered person who has entered them for home consumption under the Customs and Excise Act 2018, whether the person is registered at the time they enter the goods for home consumption or later; and
(ii) a supply of goods made by a non-resident, whether or not they made the earlier supply referred to in subparagraph (i); and
(c) the goods acquired by the person for making taxable supplies are either—
(i) not charged with tax at the rate of 0% under section 11A(1)(q) or (r); or
(ii) charged with tax at the rate of 0% under section 11A(1)(q) or (r) and, before the acquisition, have never been owned or used by the person or an associated person.

(3) The amount of input tax is—

…

(d) if the supplier and the recipient are not associated persons and the supply is not the only matter to which the consideration relates, the lesser of—
(i) the tax fraction of the purchase price; and
(ii) the tax fraction of the open market value of the supply;

…

3. Section 8(1) provides:

8 Imposition of goods and services tax on supply

(1) Subject to this Act, a tax, to be known as goods and services tax, shall be charged in accordance with the provisions of this Act at the rate of 15% on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after 1 October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply.

4. Section 11(1)(mb) provides:

11 Zero-rating of goods

(1) A supply of goods that is chargeable with tax under section 8 must be charged at the rate of 0% in the following situations:
(mb) the supply wholly or partly consists of land, being a supply—
(i) made by a registered person to another registered person who acquires the goods with the intention of using them for making taxable supplies; and
(ii) that is not a supply of land intended to be used as a principal place of residence of the recipient of the supply or a person associated with them under section 2A(1)(c); or

5. Section 14(1) provides:

14 Exempt supplies

(1) The following supplies of goods and services shall be exempt from tax:

…

(c) the supply of accommodation in any dwelling by way of—

(i) hire; or

(ii) a service occupancy agreement; or

(iii) a licence to occupy:

(d) the supply, being a sale, by any registered person in the course or furtherance of any taxable activity of—

(i) any dwelling; or

(ii) the reversionary interest in the fee simple estate of any leasehold land, —

that has been used by the registered person for a period of 5 years or more before the date of the supply exclusively for the making of any supply or supplies referred to in paragraph (c), (ca), or (cb):

6. Section 21F provides:

21F Treatment on disposal

(1) This section applies when a registered person—

(a) acquires goods or services in relation to which they do not have a full deduction, taking into account any adjustments made to input tax in adjustment periods after acquisition; and

(b) subsequently disposes, or is treated as disposing, of the goods or services in the course or furtherance of a taxable activity.

(2) The person must make a final adjustment of an amount calculated using the formula—

tax fraction × consideration × (1 – (actual deduction ÷ full input tax deduction)).

(3) For the purposes of the formula in subsection (2), —

(a) tax fraction has the meaning given in section 2(1), unless subsection (7) applies to the disposal:

(b) consideration is the amount of consideration received, or treated as received, for the supply:

(c) actual deduction is the amount of deduction already claimed, taking into account adjustments made up to the date of disposal:

(d) the amount, when added to any deduction already claimed, must not be more than the amount of the full input tax deduction on acquisition referred to in section 21D(2).

…

IS 20/06: Income tax – Tax issues arising from ownership of foreign residential rental property

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

Summary

1. If you are a New Zealand tax resident who owns a foreign residential rental property, you need to be aware of the New Zealand tax issues that may arise as a result of that ownership. As a New Zealand tax resident, you may be required to pay tax in New Zealand on any income you receive from your foreign residential rental property. You may also be required to pay tax on the same income in the country where the property is located.
2. Importantly, the way you calculate the rental income from your foreign residential property for New Zealand tax purposes may be different from the way you calculate it for foreign tax purposes. For example, the deductions you are entitled to claim, and the balance dates used may differ. You will also need to make sure you convert the foreign currency amounts into New Zealand dollars using the correct rates for the correct dates.
3. In addition to paying New Zealand tax on rental income from your foreign residential property, you may also be required to pay New Zealand tax on any gains you make if you sell the property. This is because New Zealand's land taxing rules can apply to foreign property owned by New Zealand tax residents in the same way they do for New Zealand property.
4. If you are required to pay tax on income from your foreign residential rental property both in New Zealand and overseas, you may be entitled to claim foreign tax credits in New Zealand for tax paid overseas.
5. If you have taken out a foreign currency loan to finance your foreign residential rental property, you may also need to apply the financial arrangements rules (FA rules) to that loan. Under the FA rules, the movement of foreign exchange rates will affect the amount of deemed interest expenditure able to be claimed, and can in some cases result in an amount of deemed income. Having a foreign currency loan from a non-resident lender, such as a foreign bank, may also mean you need to withhold non-resident withholding tax (NRWT) on the interest you pay on that loan, and pay that NRWT to Inland Revenue.
6. Because these issues can be complicated and the outcomes can vary depending on a person's circumstances, you may wish to seek professional tax advice tailored to your situation.

Introduction

7. This Interpretation Statement provides general guidance on the New Zealand tax issues that may arise if you are a New Zealand tax resident individual who owns foreign residential rental property.
8. This Interpretation Statement does not discuss situations involving foreign property that are:
   (a) exclusively used for private purposes; or
   (b) owned by non-residents, partnerships, trusts, or entities such as companies.
9. Although the guidance in this Interpretation Statement is for individuals, the way in which rental income and expenses are calculated for income tax purposes is generally the same for all taxpayers.

New Zealand tax residents taxed on worldwide income

10. Generally, New Zealand tax residents are taxed on their worldwide income, not just income that has a New Zealand source. This means that even though you may have returned income from your foreign rental property in the country where it is located, in most cases you will also need to return the income from that property for New Zealand tax purposes. This is the case even if you have not repatriated the income.

Tax rules vary from country to country

11. If you do need to return income from your foreign rental property for New Zealand tax purposes, it is unlikely that you will be able to simply copy the income and expense amounts you calculated for foreign tax purposes straight into your New Zealand tax return. This is because, to a greater or lesser degree, tax rules vary from country to country. For example:
   (a) the deductions you may be entitled to claim for New Zealand tax purposes may differ from those permitted overseas and vice versa;
   (b) the way gains from the sale of land are taxed in New Zealand may not be the same overseas;

(c) the applicable balance dates for a taxation income year and when income or expenses are recognised as derived or incurred vary from country to country;

(d) New Zealand's tax rules require you to convert foreign currency amounts into New Zealand dollars using particular methods; and

(e) the application of New Zealand's FA rules can alter the amount of interest you can deduct in New Zealand on a foreign currency loan. In some cases, the FA rules can even give rise to an amount of deemed income attributable to foreign exchange gains made on a foreign currency loan.

12. In addition to the examples listed above, other complexities arise relating to the availability of foreign tax credits where tax has been paid on income in a foreign country and tax is also payable on the same income in New Zealand.

13. Other New Zealand tax obligations may also arise if you own a foreign property, including:

(a) compliance with the provisional tax rules (if applicable), which require tax payments to be made throughout the tax year rather than just at the end; and

(b) withholding of NRWT or the payment of an approved issuer levy (AIL) when you pay interest on a loan to a non-resident lender.

Tax residency

Residents other than transitional residents

14. The starting point for determining whether you have any New Zealand tax obligations on your foreign property is to check whether you are a New Zealand tax resident. If you are not a tax resident of New Zealand, it is unlikely that income arising from a foreign rental property would be taxable in New Zealand.

15. The rules that determine when you will be a New Zealand tax resident are covered in Interpretation Statement "IS 16/03: Tax residence", *Tax Information Bulletin* Vol 28, No 10 (October 2016): 2. These rules differ from those used for immigration purposes. Essentially, a natural person will be a New Zealand tax resident if they:

(a) are present in New Zealand for more than 183 days in a 12-month period; or

(b) have a permanent place of abode (essentially, a home) in New Zealand.

16. It is possible for a person to be resident of two (or more) countries or territories according to each country's or territory's laws. However, if a double tax agreement (DTA) exists between New Zealand and the other country or territory, the articles of the DTA will determine the taxing rights of each country or territory, and in which country or territory the person will be regarded as being tax resident for the purposes of the DTA. Where both countries or territories are entitled to tax a person's income, the DTA will generally make provision for relieving the resulting double taxation. If no DTA exists between New Zealand and the foreign country or territory, then the person will remain a tax resident in both countries or territories. This likely means the foreign rental income will be taxed in both New Zealand and the foreign country or territory. If double taxation occurs, the taxpayer must rely on foreign tax credits for the foreign tax paid being available under New Zealand tax law. Tax credits for tax paid in DTA and non-DTA countries and territories are discussed later in this item at [58] to [76].

17. If a person is not a tax resident of New Zealand, they are liable for New Zealand tax on only their New Zealand–sourced income.

Transitional residents

18. Although New Zealand tax residents are generally taxed on their worldwide income, there is a special class of New Zealand tax residents called "transitional residents". Transitional residents are eligible for an exemption on most types of foreign-sourced income during their transitional residency period.

19. To qualify as a transitional resident (s HR 8), a person must:

(a) be a New Zealand tax resident;

(b) have not been a New Zealand tax resident in the preceding 10 years before they became a New Zealand tax resident; and

(c) have not been a transitional resident before.

20. The transitional residency period generally lasts four years, but can be up to five years, depending how a person qualifies as a New Zealand tax resident. In some circumstances, a person's transitional residency period may end early; for example, if they or their spouse, civil union partner, or de facto partner apply for family tax credits. During the transitional residency period, transitional residents are exempt from tax on all foreign-sourced income (s CW 27) except for:
    (a) employment income in connection with employment or services performed while the person is a transitional resident; and
    (b) income from a supply of services.
21. Therefore, if you are a transitional resident, you will not be taxed on any income received from a foreign rental property during the transitional residency period. However, because this income is not taxed in New Zealand, you are not permitted to claim any deductions for expenses incurred in deriving that income (s DA 2(3)). You may still be subject to taxation in the country where the property is located.
22. In addition to not being required to pay tax on most types of foreign-source income, transitional residents are not required to withhold NRWT (or pay AIL) on interest paid to a non-resident lender during the transitional residency period, as long as the loan was entered into before they became a transitional resident (s RF 12). However, a transitional resident must withhold NRWT if the loan is entered into during the transitional residency period.
23. For the remainder of this item, it is assumed you are not a transitional resident, unless otherwise stated (see [39], [41], [47], [64], [83] and also examples 1 and 2).

New Zealand tax rules apply

General – different countries have different tax rules

24. As noted at [10] and [16], if you own a foreign rental property you are likely to be taxed on your rental income from that property in the country where it is located. To calculate what tax is payable on your rental income in the foreign country, you would usually prepare tax accounts applying the foreign country's tax rules. It is important to note that the amount of taxable income calculated in your foreign tax accounts cannot simply be entered as the taxable income amount in your corresponding New Zealand tax return.
25. Because every country's tax rules are different, foreign tax calculations will typically be inappropriate for New Zealand tax purposes. Some of the general ways in which foreign tax accounts may differ from tax accounts prepared for New Zealand tax purposes include:
    (a) the basis for determining when income is "derived" (cash basis or accrual basis);
    (b) the applicable balance dates used overseas and in New Zealand; and
    (c) the methods and rates used to convert amounts of foreign income and expenses into New Zealand dollars.

Recognition of income or expenditure – cash basis or accrual basis accounting

26. In New Zealand, the two main methods used to determine when an amount of income has been derived are the cash basis and the accrual basis. On a cash basis, income is derived when it is received. On an accrual basis, income is derived when it is earned, even if the income has not yet been received. Under New Zealand tax law, a variety of factors are considered when determining whether to adopt a cash basis or an accrual basis, including the type and scale of activity that gives rise to the income. The courts have held that a cash basis may be appropriate for an individual not carrying on a business. Ordinarily, an individual with one foreign residential rental property will not be carrying on a business and the cash basis will be appropriate.
27. For more information on determining the correct method to use, see Interpretation Statement "IS 16/06: Income tax – timing – when is income from professional services derived?", *Tax Information Bulletin* Vol 29, No 1 (February 2017): 9. Although the title of IS 16/06 refers to professional services, the principles it sets out are equally applicable to deciding the correct basis for recognising rental income and expenses.
28. Although a cash basis or accruals basis might be the correct basis for you to use for New Zealand tax purposes, you should not assume that the same method will apply for the purposes of preparing your foreign tax accounts. Where the foreign method is different from what is required under New Zealand tax rules, you must complete new calculations for New Zealand tax purposes.

Balance dates

29. Another reason why tax accounts prepared for foreign tax purposes are unlikely to provide you with the correct taxable income amount for New Zealand tax purposes, is that they may have been prepared using a balance date different from that used in New Zealand.

30. While the standard New Zealand balance date is 31 March, the standard balance dates used for foreign tax purposes vary. For example, in Australia, the standard balance date is 30 June, while in the United States it is usually 31 December. This means the New Zealand 2019 tax year typically covers income and expenses for the period from 1 April 2018 to 31 March 2019, but for Australian and United States purposes, the periods are from 1 July 2018 to 30 June 2019 and 1 January 2019 to 31 December 2019, respectively.

31. A taxpayer can elect to return certain foreign-sourced income and expenses in the New Zealand tax year in which the foreign balance date falls (s EG 1). They make the election by including the foreign-sourced income and expenses in their income tax return for the New Zealand tax year – no formal election is required. For example, Australian rental income for the Australian 2019 tax year (1 July 2018 to 30 June 2019) could be returned as income in the New Zealand 2020 tax year (1 April 2019 to 31 March 2020) even though most of that income would usually be treated as derived in the New Zealand 2019 tax year.

32. This option cannot be used if you have net foreign income of more than NZD100,000. If, after making an election under s EG 1, you derive more than NZD100,000 net foreign income, the foreign source income must be returned in line with a New Zealand 31 March balance date. If this means foreign income or expenditure is now treated as being derived or incurred in a previous New Zealand tax year, then your income tax assessment for that earlier year also needs to be amended.

33. Although you may have made an election under s EG 1, you still need to ensure any deductions calculated and claimed in your foreign tax accounts are permitted under New Zealand tax law and that the foreign currency amounts used in the foreign tax accounts are correctly converted into New Zealand dollars.

Foreign exchange rates and conversion timing

34. Where you have foreign currency income and expenses, then New Zealand's tax rules require these amounts to be converted to New Zealand dollars for the purposes of calculating your New Zealand tax liability.

35. In some cases, the Act prescribes a currency conversion method or exchange rate source to use, but in most cases it does not. Where the Act does not prescribe a currency conversion method or exchange rate source the default method is the close of trading spot exchange rate on the date the amount is required to be measured or calculated (s YF 1(2)). However, the Commissioner can approve other methods and rates to use (s YF 1(5)) to minimise compliance costs.

36. The Commissioner has approved annual and monthly currency conversion methods that may be used by individuals who own foreign rental property instead of or in conjunction with the spot rate, (see *Approval – foreign rental property amounts – currency conversion* (Approval). The Commissioner has also approved the foreign exchange rates published by Inland Revenue on its website (**www.classic.ird.govt.nz/how-to/overseas-currency**) for use by individuals who have an interest in a foreign rental property or exchange rates from another reputable source. For further guidance on the above currency conversion methods and exchange rate sources, see the Approval.

37. It is important to note that the Approval does not apply when converting foreign amounts to New Zealand dollars for the purposes of the FA rules. Where a foreign currency loan falls within the scope of the FA rules, foreign currency amounts must be converted to New Zealand dollars using the methods and rates prescribed under the FA rules (as discussed later in this item and in Interpretation Statement "IS 20/07: Income tax –Application of the financial arrangements rules to foreign currency loans used to finance foreign rental properties").

Income – three types covered in this item

38. This item covers the three types of income that may arise where a New Zealand tax resident owns a foreign rental property:

- foreign rental income;
- income from the sale of the property; and
- in some cases, FA income resulting from foreign exchange gains.

Foreign rental income

39. Unless you are within the transitional residency period, you will be required to pay tax on the foreign rental income you receive (s CC 1). This will be the case even if you are required to pay tax on that same rental income in the country where the property is located. However, where this occurs, you may be entitled to a foreign tax credit in New Zealand. The availability of foreign tax credits is discussed from [58].

Income from the sale of the property

40. If you sell your foreign residential rental property, you may be required to pay tax on any gain under New Zealand's land taxing provisions, even if the sale is not taxable in the country where the property is located. For example, you may be required to pay tax on a gain you make when you sell a foreign residential rental property:
    - that you purchased with the purpose or intention of sale (s CB 6); or
    - within five years, or two years if you purchased the property before 29 March 2018 (the s CB 6A "bright-line" test).
41. If you are a transitional resident, the sale of a foreign rental property during your transitional residency period will not be taxable in New Zealand even if it would ordinarily be caught by one of New Zealand's land taxing rules. However, the sale of that same property may be taxable if you sell it **after** the transitional residency period has ended (assuming you have remained a New Zealand tax resident). This will be the case even if you purchased the property before or while you were a transitional resident. For property sold after the transitional residency period, the land taxing rules will apply as normal as you are no longer a transitional resident. For example, the bright-line test will include the period for which you were a transitional resident.
42. If the proceeds from the sale of a foreign rental property are taxed in New Zealand and in the country where the property is located, you may be entitled to a foreign tax credit. The availability of foreign tax credits is discussed from [58].

Financial arrangement income arising from foreign currency gains

43. The third type of income that may arise from owning a foreign rental property is income calculated under the FA rules, as a result of foreign exchange gains.
44. If you own a foreign rental property, you may also have a foreign currency loan from a foreign bank or other lender. Because a foreign currency loan will generally meet the definition of a "financial arrangement", you will need to consider whether the FA rules apply to that loan. Under the FA rules, an increase in the value of the New Zealand dollar will usually have the effect of lowering the interest expenditure you are deemed to have incurred on your foreign currency loan. However, if the foreign exchange gain is significant enough, the FA rules may deem you to have derived an amount of FA income from the foreign currency loan. Where this occurs, you will be liable for tax on that deemed FA income.
45. Because the application of the FA rules to foreign currency loans is complicated, the Commissioner has issued "IS 20/07: Income tax –Application of the financial arrangements rules to foreign currency loans used to finance foreign rental properties" in conjunction with this general item.

Expenses

46. When calculating your taxable income from a foreign rental property, you are generally entitled to claim deductions available under New Zealand tax law. Because the rules on deductibility vary greatly from country to country, do not assume that deductions you are permitted for foreign tax purposes will be allowed under New Zealand's tax rules to the same extent or in the same way. If your deductible expenses relating to residential rental property (including foreign residential rental property) exceed your rental income and/or gains on the sale of residential rental property, the deductions that can be allocated to the income year may be limited. Residential rental property deductions are generally "ring-fenced", meaning they can only be used against income from residential property, with any deductions in excess of the income being carried forward to the next income year you derive income from residential property. Note, these ring-fencing rules do not apply to residential property that comes under the mixed-use asset rules. For further information on the residential ring-fencing rules, see *Tax Information Bulletin* Vol 31, No 8 (September 2019): 53.
47. Note that because foreign-sourced income, such as foreign rental income, derived by a transitional resident is exempt income, transitional residents are not permitted to claim any deductions for expenses incurred in deriving that income (s DA 2(3)).

Repairs and maintenance

48. Whether an expense is repairs and maintenance or a capital improvement will make a difference to how that expense is treated for tax purposes. Unlike capital improvement expenses, repairs and maintenance expenses can generally be deducted in the year they are incurred. While New Zealand's rules for differentiating between repairs and maintenance and capital improvement expenses may appear to be the same as those applied in the country where your rental property is located, do not assume they are identical in every case. For example, some countries, such as the United States, may also allow you to deduct capital improvement expenses under a certain dollar amount as if they were repairs and maintenance expenses.

49. For further information on New Zealand's repairs and maintenance rules, see Interpretation Statement "IS 12/03: Income tax – deductibility of repairs and maintenance expenditure – general principles", *Tax Information Bulletin* Vol 24, No 7 (August 2012): 68. Information in "QB 20/01: Can owners of existing residential properties claim deductions for costs incurred to meet Healthy Homes standards?" on the approach for determining capital and revenue expenses may also be helpful, although to the extent that QB 20/01 discusses New Zealand's healthy homes standards it will not be directly applicable.

Depreciation

50. Under New Zealand tax law, you are not permitted to claim a deduction for the depreciation of a residential rental property (the building or the land), although deductions are permitted on the depreciation of chattels in a rental property such as furniture or appliances. Generally, an annual deduction amount is calculated using a rate set by Inland Revenue based on the estimated useful life of a chattel. Note that depreciation rates may vary between the country where the property is located and New Zealand. For example, for New Zealand depreciation purposes, a domestic refrigerator has an estimated useful life of eight years. The same refrigerator, however, has a 12-year estimated useful life under the Australian depreciation rules.

51. The cost of low-value items may be deducted in full in the year they are purchased. Low-value items are items that cost:
    - $500 or less, for chattels acquired on or after 19 May 2005 and before 17 March 2020;
    - $5,000 or less, for chattels acquired on or after 17 March 2020 and before 17 March 2021;
    - $1,000 or less, for chattels acquired on or after 17 March 2021 (s EE 38).

52. For items purchased using foreign currency, the cost will need to be converted to NZD to determine if the thresholds apply.

53. For further information on New Zealand's depreciation rules for residential rental properties, see Interpretation Statement "IS 10/01: Residential rental properties – depreciation of items of depreciable property", *Tax Information Bulletin* Vol 22, No 4 (May 2010): 16 and Inland Revenue guide "IR264 Rental income – tax rules for people who rent out residential property and holiday homes" April 2020. As already noted, information in QB 20/01 on the approach for determining capital and revenue expenses may also be helpful.

Interest deductions

54. Under New Zealand tax law, the interest on a loan financing a rental property, including a foreign rental property, can generally be claimed as a deduction against your rental income. New Zealand's rules on interest deductions may not be the same as those in other jurisdictions. For example, under United Kingdom tax law, instead of deductions for interest paid on rental property loans, taxpayers receive a tax credit based on 20% of their interest payments.

55. Note that where you have a foreign currency loan, you may be required to apply the FA rules to calculate your expenditure (or income) on the loan. Under the FA rules, foreign exchange movements will affect the amount of deemed interest expenditure you have on your foreign currency loan. For more information on applying the FA rules to foreign currency loans, see "IS 20/07: Income tax –Application of the financial arrangements rules to foreign currency loans used to finance foreign rental properties".

Mixed-use assets

56. New Zealand's mixed-use asset rules apply to assets (including foreign assets) that are used to earn income, used privately, and are unused for 62 days or more during the year. The rules ensure an appropriate proportion of the expenses that relate to the "unused" period is not deductible. The proportion that is deductible is based on the amount of income-earning use relative to the total use of the asset. If you own a foreign property, consider the mixed-use asset rules as if the property were in New Zealand. Note, the ring-fencing rules for residential property deductions do not apply to mixed-use assets.

57. For further information on the mixed-use asset rules, see Questions We've Been Asked "QB 19/07: How do the mixed-use asset income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately?", *Tax Information Bulletin* Vol 31, No 6 (July 2019): 16.

Entitlement to foreign tax credits

58. Foreign tax credits help alleviate double taxation where a person is taxed on the same income by two countries. Double taxation may arise for New Zealand tax residents with rental income or gains from foreign property. This is because New Zealand tax residents are taxed on their worldwide income in New Zealand and because they are also likely to be taxed on any income or gains from foreign property in the country where the land is situated. Therefore, it is important for New Zealand tax residents to understand whether they are eligible for foreign tax credits in New Zealand to offset the foreign tax they have paid.

59. You may be entitled to claim a foreign tax credit, to the extent that tax is paid on the same income in New Zealand in two circumstances. If the foreign tax on rental income and/or gains on land sales:

    (a) is covered by a DTA, a credit may be allowed under and in accordance with the terms of that DTA; or

    (b) is not covered by a DTA, a foreign tax credit may be allowed directly under subpart LJ.

60. A foreign tax credit is matched with the income year in which the foreign income on which the foreign tax was paid is derived for New Zealand tax purposes. If the foreign tax is not paid until after the income year in which you are required to return the foreign income for New Zealand tax purposes, you may have to apply to the Commissioner to amend your income tax assessment for the year to give credit for the foreign tax paid. The application must be made within the time limit prescribed in s 78B of the Tax Administration Act 1994 (TAA). For more information on claiming foreign tax credits, see Interpretation Statements "IS 14/02: Income tax – foreign tax credits – what is a tax of substantially the same nature as income tax imposed under s BB 1?", *Tax Information Bulletin* Vol 26, No 5 (June 2014): 3 and "IS 16/05: Income tax – foreign tax credits – how to claim a foreign tax credit where the foreign tax paid is covered by a double tax agreement", *Tax Information Bulletin* Vol 28, No 12 (December 2016): 41.

Preliminary requirements

Residents other than transitional residents

61. Regardless of whether tax on foreign rental income or gains on foreign property is covered by a DTA, the following requirements must be met before a taxpayer is eligible for a foreign tax credit. You must:

    (a) be a New Zealand tax resident;

    (b) have derived foreign-source income that is taxable in New Zealand and in another country; and

    (c) have paid foreign income tax on that foreign-source income.

62. If any of these requirements is not met, you will not be entitled to a foreign tax credit.

63. In the case of gains from land sales, it depends on the circumstances of each sale as to whether the proceeds will be taxable in New Zealand. For example, residential land sold within the bright-line period (see [40]) will be subject to New Zealand tax (s CB 6A). However, if the same land were sold after the bright-line period, the proceeds would not be assessable in New Zealand (assuming no other land taxing provisions applied). Therefore, it cannot be assumed that because land sale proceeds are subject to foreign tax, that the same amount will necessarily be assessable income in New Zealand (and vice versa).

Transitional residents

64. Because transitional residents are exempt from tax on almost all foreign-source income during the transitional residency period, including foreign rental income and gains on foreign land sales, transitional residents are not entitled to a foreign tax credit for any foreign tax they have paid on that income.

Tax covered by a double tax agreement

Examples of taxes covered in specific agreements

65. If a DTA is in force between New Zealand and the country where tax on foreign rental income or gains from land sales has been paid, the first step is to check that the tax paid is covered by the DTA.

66. The relevant article in the DTA is usually entitled "Taxes covered" and is typically article 2. Depending on the wording of the DTA, tax on foreign rental income and gains from land sales will be covered by the DTA, if they are:

    (a) expressly listed as taxes covered; or

    (b) a tax on income or capital as defined in article 2(1) and (2) of the DTA; or

    (c) a subsequently enacted tax that is "identical or substantially similar" to one of the taxes expressly covered (article 2(4)).

67. The following illustrates the way foreign rental income and land sales proceeds are covered under several common DTAs:
    (a) **Australia–New Zealand DTA** – Under article 2 of this DTA, federal tax paid in Australia on Australian-sourced rental income and gains from land sales are covered by the DTA. Therefore, foreign tax credits are available to New Zealand tax residents, to the extent calculated under the Act. Although Australian tax on gains from land sales is not specifically referred to in this DTA, it is treated as income tax for the purposes of applying the DTA because Australia's capital gains tax is incorporated into its federal income tax legislation.
    (b) **China–New Zealand DTA** – Under article 2 of this DTA, tax paid in China on China-sourced rental income and gains from land sales are specifically covered by the DTA. Therefore, foreign tax credits are available to New Zealand tax residents, to the extent calculated under the Act.
    (c) **United States – New Zealand DTA** – Under article 2 of this DTA, federal tax paid on United States–sourced rental income and tax on gains from land sales are covered by the DTA. Therefore, foreign tax credits for these taxes are available to New Zealand tax residents, to the extent calculated under the Act.
    (d) **United Kingdom – New Zealand** – Under article 2 of this DTA, tax paid on United Kingdom–sourced rental income and gains from land sales are specifically covered by the DTA. Therefore, foreign tax credits are available to New Zealand tax residents, to the extent calculated under the Act.
68. For further discussion on the availability of foreign tax credits under a DTA, see Interpretation Statement IS 16/05.

Residency of a taxpayer for the purposes of a double tax agreement

69. If the tax paid is covered by a DTA, it becomes necessary to determine if the taxpayer is a New Zealand tax resident under that DTA.
70. If the taxpayer is tax resident in only New Zealand, there is no need to consider the residency article under the DTA. However, if a taxpayer is tax resident in New Zealand and in the foreign country, the residency article of the DTA determines which of the two countries the taxpayer is treated as being tax resident of for the purposes of the DTA. Usually, residency is decided in the first instance by asking in which of the two countries does the taxpayer have a permanent home available to them.
71. If the taxpayer has a permanent home in both countries, the residency article of a DTA typically sets out a series of tie-breaker tests that ultimately decide which country the taxpayer will be resident in for the purposes of the DTA. See the detailed discussion on how the tie-breaker tests commonly found in DTAs apply in IS 16/05.

Allocation of taxing rights under a double tax agreement

72. If the tax is covered by the DTA and the taxpayer is a New Zealand tax resident for the purposes of the DTA, the next step is to determine whether one or both countries have the right to tax the income in question. In general, New Zealand's DTAs allocate taxing rights on rental income and gains from land sales to the country where the land is located. However, New Zealand retains the right to tax its residents on their world-wide income. This means for foreign rental income and gains from land sales, both New Zealand and the other country have shared rights to tax. Therefore, there will often be "double taxation" on these amounts, and it is necessary to consider the "elimination of double taxation" article to the DTA (if such an article is included in the DTA).
73. As the name suggests, the elimination of double taxation article generally provides that where a person is a New Zealand tax resident for the purposes of the DTA and they are taxed by both countries on the same income, New Zealand will provide the taxpayer with a tax credit for the tax paid in the other country, to the extent that tax is payable on the same income in New Zealand. This is also subject to any limitations found in the specific DTA or New Zealand's domestic legislation. For a detailed discussion on calculating the foreign tax credits a taxpayer is entitled to, see IS 16/05. If the tax paid in the foreign country is less than the tax payable on the same income in New Zealand, the difference is payable as tax in New Zealand.

Tax not covered by a double tax agreement

74. In some cases, tax paid on foreign rental income or gains from land sales overseas may not be covered by a DTA. This will usually be because New Zealand does not have a DTA with the country where the tax is paid. However, there may be situations where New Zealand does have a DTA with a particular country, but the tax paid is not of a type covered by the articles of that DTA.

75. In either case, a taxpayer may still be entitled to a foreign tax credit under subpart LJ. The central issue for foreign taxes not covered by a DTA is whether the tax paid is tax of "substantially the same nature" as income tax imposed under s BB 1 (ss LJ 3 and YA 2(5)).

76. For further guidance on deciding whether tax paid on foreign rental income or gains from land sales overseas will be eligible for a foreign tax credit in New Zealand, see Interpretation Statement "IS 14/02: Income tax – foreign tax credits – what is a tax of substantially the same nature as income tax imposed under s BB 1?", *Tax Information Bulletin* Vol 26, No 5 (June 2014): 3.

Other New Zealand tax obligations

Provisional tax

77. If you have an end-of-year tax bill (your residual income tax) of more than NZD5,000 for any reason (this may be as a result of foreign rental income, gains on the sale of a foreign rental property, or otherwise), you must pay income tax for the following year in instalments (provisional tax), rather than at the end of the year in a lump sum. The NZD5,000 threshold applies for the 2021 and later income years. For income years before 2021, the threshold was NZD2,500. For further information on provisional tax, including the methods for calculating provisional tax payments, and when such payments are due, see the Inland Revenue website (**www.ird.govt.nz/topics/income-tax/provisional-tax**) and the IR289 Provisional Tax guide.

Obligation to withhold Non-Resident Withholding Tax

78. It is common for people who own a foreign rental property to have a loan from a non-resident lender. In these situations, because a New Zealand tax resident borrower will be paying interest to a non-resident, the New Zealand tax resident may be required to withhold NRWT from the interest paid, and to pay the tax withheld to Inland Revenue. This is unless they use the borrowed money for the purposes of a business they carry on outside New Zealand through a fixed establishment outside New Zealand (s YD 4(11)(b)(i)). As noted at [26], ordinarily, an individual with one foreign residential rental property will not be carrying on a business.

79. Another exception to the requirement to withhold is where the non-resident lender is a registered bank engaged in business in New Zealand through a fixed establishment in New Zealand and is not associated with the borrower (s RF 2(2B)). The most common form of a "fixed establishment" will be a branch. For example, most Australian registered banks engage in business in New Zealand through a branch. However, note that some banks carry on business in New Zealand using a subsidiary company rather than a branch. Where a subsidiary is used, the non-resident lender is unlikely to have a fixed establishment in New Zealand. A list of the banks registered in New Zealand, and whether they operate in New Zealand through a branch or a subsidiary, is on the Reserve Bank of New Zealand's website (**www.rbnz.govt.nz/regulation-and-supervision/banks/register**). The rate of NRWT that must be withheld depends on whether New Zealand has a DTA with the country or territory where the lender is resident:

- If the lender is from a non-DTA country or territory, then the rate of NRWT is 15%.
- If the lender is from a DTA country or territory, then the rate of NRWT will be set by the DTA (often 10%).

80. A lender may require interest payments to be grossed-up to cover the NRWT withheld. For example, for an interest payment of AUD2,000 subject to NRWT at 10%, the gross amount of interest would be AUD2,222, calculated as follows:

$$\text{AUD2,000} \times \frac{100}{90} = \text{AUD2,222}$$

81. The amount of NRWT would be AUD222.22 (10% of AUD2,222).

82. From 1 April 2020, if you are required to withhold NRWT from interest you pay, you must provide Inland Revenue with information about the interest and the lender you pay it to (investment income information). The information must be provided electronically by the 20th of the month following the month in which you pay the interest.

83. If you are a transitional resident and are paying interest to a non-resident lender in relation to money borrowed while you were non-resident, the NRWT on interest payments is 0% (s RF 12). Practically, this means you are not required to deduct NRWT from the interest payments you make to the non-resident lender while you are a transitional resident.

84. Instead of withholding NRWT, you may request approval from Inland Revenue to pay a 2% approved issuer levy (AIL). For more information see "IR395 Approved issuer levy (AIL), a guide for payers" April 2019.

85. For more information on NRWT and investment income information, see "IR291 NRWT – payer's guide" March 2020.

Examples

86. The following examples illustrate the application of the law in relation to tax issues arising from ownership of foreign rental property.

Example 1

Manuel is a tax resident of the United Kingdom (UK). He migrates to New Zealand to take up a new job. Manuel becomes a New Zealand tax resident on 30 September 2017. Manuel has never been a New Zealand tax resident before and is eligible to be a transitional resident. Manuel has a house in the UK that he rents out. He also has a GBP300,000 loan with a UK bank. The UK bank does not have a branch in New Zealand. For the purposes of the FA rules, Manuel is a cash basis person.

For the 48-month period (beginning on 30 September 2017) that Manuel is a transitional resident:

- he will not be liable for New Zealand tax on the foreign rental income he receives from his UK property;
- the GBP300,000 loan will be an excepted financial arrangement, so is not subject to the FA rules;
- he is not required to withhold NRWT on the interest paid to the UK bank.

Manuel will still be liable for tax in the UK on the rental income he earns from his UK property.

After the transitional period, Manuel continues to be a New Zealand tax resident. Because Manuel is no longer entitled to the transitional resident exemption on foreign income the following occurs:

- Manuel is required to return the rental income he receives on his UK property in New Zealand. Because of the difference between New Zealand and UK tax laws, Manuel prepares two sets of tax accounts: one set is prepared applying UK tax rules and the other applying New Zealand tax rules. Under the UK–New Zealand DTA, to the extent that Manuel pays UK tax on this rental income, he is entitled to claim a foreign tax credit to the extent permitted under subpart LJ.
- Manuel's loan is no longer an excepted financial arrangement, so he must consider the application of the FA rules to that loan. As a cash basis person, Manuel is required to do a base price adjustment only if he ceases to be a New Zealand tax resident or if the loan matures. Neither of these events occurs in this tax year, so Manuel is not required to make any calculations under the FA rules.
- Manuel is required to withhold NRWT from the interest he pays on his loan and pay these deducted amounts to New Zealand Inland Revenue and provide the required investment income information. Under the UK–New Zealand DTA, Manuel is required to withhold NRWT at a rate of 10%. The UK bank requires Manuel to gross-up the interest he pays to cover the amount of NRWT he withholds. Manuel's monthly interest payments are GBP1,151. Grossed-up monthly payments are GBP1,278.89:

$$\text{GBP}1{,}151 \times \frac{100}{90} = \text{GBP}1{,}278.89$$

Manuel must withhold GBP127.89 NRWT from each payment.

Example 2

Mei migrated to New Zealand just over four years ago. Her status as a transitional resident ended on 31 August 2017. She still owns an apartment in Shanghai that she rents out. As at 1 September 2017, Mei had a RMB2,500,000 loan from a Chinese bank that does not have a fixed establishment in New Zealand.

Although Mei had not been required to withhold NRWT from the interest payments she made on her Chinese bank loan while she was a transitional resident, she is now required to do so. Under the China–New Zealand DTA, Mei needs to withhold NRWT at 10%. Because the NRWT she will deduct in the year is likely to exceed NZD500, she will need to pay the NRWT she withholds to New Zealand Inland Revenue monthly. She will need to provide investment income information to the Commissioner by the 20th of the month following the month in which she pays interest to the Chinese bank.

As Mei is a New Zealand tax resident, the rental income she receives from her Shanghai apartment is taxable in New Zealand. However, she is entitled to claim deductions for expenses incurred in deriving that rental income, as if the apartment were located in New Zealand. Under the China–New Zealand DTA, Mei will be entitled to claim a foreign tax credit in New Zealand for tax paid in China on the same rental income, as calculated under subpart LJ.

Depending on the value of Mei's other financial arrangements, both in New Zealand and overseas, she may also have foreign exchange income or expenses arising from her loan, as calculated under Determination G9A and the FA rules.

Example 3

Megan has been New Zealand tax resident all her life. She recently purchased a Gold Coast property that she uses as a holiday home three months of the year. For the other nine months of the year, the property is listed for rent on a short-stay accommodation website.

Megan financed the purchase of the property with an AUD400,000 loan from an Australian bank. The Australian bank has a branch in New Zealand. After four years, Megan sells the Australian property and makes an AUD50,000 profit.

For the four years the property is rented out, Megan must return the rental income in New Zealand and Australia. Megan files her New Zealand tax returns for the 1 April to 31 March New Zealand tax year by the 7 July deadline. She files her Australian tax returns for the 1 July to 30 June Australian tax year by the 31 October deadline. To make sure she complies with both Australian and New Zealand tax laws, she prepares separate tax accounts for each country. In each year Megan's rental income exceeds her rental expenditure so that for New Zealand tax purposes she has no ring-fenced deductions to carry forward under Subpart EL. When converting Australian dollar amounts into New Zealand dollar amounts for the purposes of preparing her New Zealand tax accounts, Megan applies the Approval for foreign rental property amounts and uses the monthly rate. Under the Australian–New Zealand DTA, Megan is eligible for a foreign tax credit for the Australian tax she pays on the rental income from the property to the extent calculated under subpart LJ. Because Megan returns the foreign rental income for New Zealand tax purposes before she pays Australian tax on it, Megan must apply to the Commissioner to amend her New Zealand tax returns to give credit for the Australian tax after she has paid it. She must make the application within the time limit prescribed in s 78B of the TAA.

Megan is not required to withhold NRWT from the interest payments she makes to the Australian bank or to provide investment income information to the Commissioner. The interest payments are not classed as non-resident passive income because they are being paid to a non-resident registered bank that is engaged in business in New Zealand through a fixed establishment in New Zealand, in this case, a branch.

Because Megan sold the Gold Coast property within five years of purchase, she is liable for tax in New Zealand on the AUD50,000 gain she made on the sale under s CB 6A. Megan is also liable to pay tax on the same gain in Australia. Under the Australian–New Zealand DTA she will be eligible for a tax credit on the rental income and the gain from the sale of the property to the extent calculated under subpart LJ. As with previous income years, because Megan returns the foreign rental income and gain for New Zealand tax purposes before she pays Australian tax on those amounts, Megan must apply to the Commissioner to amend her New Zealand tax return to give credit for the Australian tax once she has paid it.

Megan is a cash basis person. As a cash basis person, she is required to make a base price adjustment because she repaid her Australian loan in full on selling her Gold Coast property. Since she took out her loan, the New Zealand dollar has strengthened against the Australian dollar. After calculating the base price adjustment, Megan finds she has derived financial arrangement income, which she returns in the relevant income year. As a result of making a gain on the sale of the Gold Coast property, and deriving financial arrangement income, it is likely that Megan will have residual income tax greater than NZD5,000 for that year. Megan therefore needs to consider how the provisional tax rules apply to her.

References

Subject references

Foreign property

Foreign tax credits

Non-resident withholding tax

Transitional residents

Legislative references

Income Tax Act 2007, ss BB 1, CB 6A, CB 6, CC 1, CW 27, DA 2, EG 1, HR 8, subpart LJ, LJ 3, RF 2, RF 12, YF 1, YF 2 Tax Administration Act 1994, s 78B

Related rulings/statements

"FX 20/01: Approval – foreign rental property amounts – currency conversion" (July 2020).

"IS 10/01: Residential rental properties – depreciation of items of depreciable property", *Tax Information Bulletin* Vol 22, No 4 (May 2010): 16.

"IS 12/03: Income tax – deductibility of repairs and maintenance expenditure – general principles", *Tax Information Bulletin* Vol 24, No 7 (August 2012): 68.

"IS 14/02: Income tax – foreign tax credits – what is a tax of substantially the same nature as income tax imposed under s BB 1?", *Tax Information Bulletin* Vol 26, No 5 (June 2014): 3.

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

"IS 16/05: Income tax – foreign tax credits – how to claim a foreign tax credit where the foreign tax paid is covered by a double tax agreement", *Tax Information Bulletin* Vol 28, No 12 (December 2016): 41.

"IS 16/06: Income tax – timing – when is income from professional services derived?", *Tax Information Bulletin* Vol 29, No 1 (February 2017): 9.

"QB 19/07: How do the mixed-use asset income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately?", *Tax Information Bulletin* Vol 31, No 6 (July 2019): 16.

"QB 20/01: Can owners of existing residential properties claim deductions for costs incurred to meet Healthy Homes standards?", (17 June 2020).

"IS 20/07: Income tax – Application of the financial arrangements rules to foreign currency loans used to finance foreign rental property" (July 2020).

"IR264 Rental income – tax rules for people who rent out residential property and holiday homes" April 2020.

"IR289 Provisional Tax guide" March 2020

"IR291 NRWT – payer's guide" March 2020.

"IR395 Approved issuer levy (AIL), a guide for payers" April 2019.

IS 20/07: Income tax – Application of the financial arrangements rules to foreign currency loans used to finance foreign residential rental property

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

Summary

1. If you are a New Zealand tax resident who has a foreign currency loan, you need to consider whether the loan is subject to the financial arrangements rules (FA rules). If the FA rules apply, they may affect the amount of expenditure you are deemed to incur, and you may be required to pay tax on deemed financial arrangement income as a result of an increase in the value of the New Zealand dollar.

Introduction

2. This Interpretation Statement explains when and how the FA rules apply to a foreign currency loan that is used by a New Zealand resident individual to finance foreign residential rental property. This statement does not discuss situations involving foreign property owned by non-residents, partnerships, trusts, or entities such as companies. Nor does it deal with foreign currency loans used exclusively for a private or domestic purpose such as a private holiday home.

3. Although people often use the terms "loan" and "mortgage" interchangeably, especially in the context of real estate purchases, a loan (or loan agreement) is not technically a mortgage. A mortgage is the name of the type of security the borrower gives to the lender in case the loan is not repaid as agreed. For this reason, we use the term 'foreign currency loans' throughout this statement.

Scope of the financial arrangements rules

4. The FA rules apply only to financial arrangements as that term is defined in s EW 3. A foreign currency loan meets the initial definition of financial arrangement because it is an arrangement under which a person (the borrower) receives money (the loan advanced) in return for the borrower providing money (the principal borrowed together with interest) to another person at a future time or on a future event occurring (or not occurring, as the case may be). Foreign currency loans are also a "debt", which is given as an example of a financial arrangement in s EW 3(3)(a).

5. Despite foreign currency loans being covered by the initial definition of financial arrangement, certain financial arrangements are excluded from the scope of the FA rules. These arrangements are referred to as "excepted financial arrangements" (ss EW 4 and EW 5). In certain circumstances, discussed from [6], a foreign currency loan may be an excepted financial arrangement.

Excepted financial arrangements

6. Section EW 4 provides that excepted financial arrangements are not financial arrangements for the purposes of the FA rules. Section EW 5 describes the types of financial arrangements that are excepted financial arrangements.

7. A foreign currency loan used to finance a foreign residential rental property may be an excepted financial arrangement if the:
   - borrower is a transitional resident (s EW 5(17)); or
   - loan is a variable principal debt instrument (s EW 5(25)).

8. A foreign currency loan that is used to finance a foreign residential rental property cannot be an excepted financial arrangement under s EW 5(18). Section EW 5(18) requires, among other things, that the loan be used for a private or domestic purpose. The Commissioner considers that s EW 5(18) requires that the property be used exclusively for a private or domestic purpose. Renting a foreign property to third parties is not a private or domestic purpose (even if the property is used privately on occasion).

Transitional residents' arrangements (s EW 5(17))

9. The first situation in which a foreign currency loan could be an excepted financial arrangement is if you are a transitional resident. In this case, you may not be required to apply the FA rules on the basis that the loan is an excepted financial arrangement under s EW 5(17).

10. Section EW 5(17) provides:

    Certain arrangements to which transitional resident is party

    (17) An arrangement to which a transitional resident is a party is an excepted financial arrangement for the transitional resident if—

    (a) no other party to the arrangement is a New Zealand resident; and

    (b) the arrangement is not for a purpose of a business carried on in New Zealand by a party to the arrangement.

11. A transitional resident is a special category of New Zealand tax residents, which will include people who are new migrants to New Zealand or former New Zealand tax residents returning to New Zealand after an extended period overseas.
12. To qualify as a transitional resident, you must:
    - be a New Zealand tax resident;
    - have not been a New Zealand tax resident in the preceding 10 years before becoming a New Zealand tax resident; and
    - have not been a transitional resident before.
13. The transitional residency period is generally four years, but can sometimes last up to five years, depending on how you became a New Zealand tax resident.
14. This means that most foreign currency loans held by transitional residents will be excepted financial arrangements and not subject to the FA rules. Section EW 5(17) does not distinguish between financial arrangements entered into before or during the transitional residency period, with both being excepted financial arrangements during the transitional residency period.
15. A foreign currency loan to a transitional resident will not be an excepted financial arrangement under s EW 5(17), if:
    - another party to that loan is a New Zealand tax resident; and
    - the loan is for a purpose of a business carried on in New Zealand by any party to the loan.
16. While it is conceivable the above two criteria might arise for some foreign currency loans to transitional residents, it is not considered to be a common situation in the context of foreign rental properties.
17. When a person ceases to be a transitional resident, and continues to be a New Zealand tax resident, any foreign currency loans they may be a party to will no longer be excepted financial arrangements under s EW 5(17). Such loans will revert to being financial arrangements, and therefore subject to the FA rules, on the day after the taxpayer ceased to be a transitional resident.
18. For the purposes of applying the FA rules to such financial arrangements, the taxpayer is treated as becoming a party to the foreign currency loan on the day after they cease to be a transitional resident (s EW 37). The initial consideration paid to the taxpayer will, for the purposes of the FA rules, be the outstanding balance of the loan (including accrued amounts) on that day.

Example 1: Change in tax residency status

Davina is a tax resident of Australia and owns her own home there. She moves to New Zealand after accepting a job with a New Zealand–based company. Davina becomes a New Zealand tax resident on 31 July 2019. She has not been a New Zealand tax resident before and is eligible to be a transitional resident.

Davina keeps her Australian home to rent it out. She has a fixed-term table loan of AUD400,000 with an Australian registered bank with a branch in New Zealand. Davina is a cash basis person for the purposes of the FA rules. (Whether a person is a cash basis or non-cash basis person is discussed from [27].)

For the 48-month period (beginning on 31 July 2019) that Davina is a transitional resident, her AUD400,000 loan is an excepted financial arrangement under s EW 5(17), so is not subject to the FA rules.

After Davina's transitional residency period ends, her Australian currency loan ceases to be an excepted financial arrangement under s EW 5(17). Because Davina rents out her Australian home, her Australian loan cannot be an excepted financial arrangement under s EW 5(18) as this provision requires that the loan be used for a private or domestic purpose.

The Australian loan will not be an excepted financial arrangement under s EW 5(20) because it is not a variable principal debt instrument. Therefore, the Australian loan will be subject to the FA rules once Davina's transitional residency period ends. The initial consideration paid to Davina for the purposes of the FA rules will be the loan balance outstanding when her transitional residency period ends, including accrued amounts as at that time (s EW 37).

Davina will not be required to withhold non-resident withholding tax on interest she pays to the lender because it is registered bank with a branch in New Zealand (s RF 2(2B)). Non-resident withholding tax obligations are explained in Interpretation Statement "IS 20/06: Income tax – Tax issues arising from ownership of foreign residential rental property".

Variable principal debt instruments

19. The second situation in which a foreign currency loan could be an excepted financial arrangement is if the:
    - loan is a "variable principal debt instrument" (VPDI); and
    - total value of **all** VPDIs to which the taxpayer is a party, does not exceed NZD50,000 at any point in the year (s EW 5(25)).

    A VPDI might be a revolving credit facility where the borrower can borrow or repay principal at any time, a credit card account or an everyday banking cheque account.
20. Because the threshold for the VPDI is relatively low and takes into account all of the VPDIs that a person is party to, including bank accounts and credit cards, it would seem unusual that a foreign currency loan would qualify as an excepted financial arrangement under s EW 5(25).
21. If you have a foreign currency loan that is an excepted financial arrangement under s EW 5, you are still able to elect for it to be treated as a financial arrangement under s EW 8.

Excepted financial arrangements – summary

22. If your foreign currency loan is an excepted financial arrangement, you are not required to apply the FA rules to it. However, you should regularly check to confirm that your foreign currency loan remains an excepted financial arrangement. For example, if you previously used the loan to finance a foreign property that was used exclusively for private or domestic use (s EW 5(18)), but you later rent the property out, your foreign currency loan will cease to be an excepted financial arrangement and will become subject to the FA rules. Other events, such as your ceasing to be a transitional resident, will also affect the status of your foreign currency loan.
23. Even if your foreign currency loan is an excepted financial arrangement, you may still need to withhold non-resident withholding tax or pay approved issuer levy. This is explained in Interpretation Statement "IS 20/06: Income tax – Tax issues arising from ownership of foreign residential rental property".

Arrangements subject to the financial arrangements rules

24. If your foreign currency loan is not an excepted financial arrangement under s EW 5, it will be a financial arrangement and subject to the FA rules. However, the calculations required under the FA rules and when you need to make those calculations, depend on whether you are a non–cash basis person or a cash basis person.
25. If you are a non-cash basis person, you are required to apply a spreading method every year for the term of the arrangement, except for the income year in which you are required to make a base price adjustment (BPA). BPAs and the events that trigger them are discussed from [52].
26. While you are a cash basis person, you are not required to apply a spreading method and may account for interest on a cash basis over the term of your loan. However, you must calculate a BPA for the year in which the loan matures or the year in which you cease to be a New Zealand tax resident.

Cash basis and non-cash basis persons

27. The test for determining whether you are a cash basis person or a non-cash basis person has two steps (s EW 57).

First step in the cash basis person test

28. The first step of the cash basis person test requires you to meet at least one of the following thresholds:
    (a) The absolute value of your financial arrangement income and expenditure for the income year under all your financial arrangements is NZD100,000 or less (the income and expenditure threshold (s EW 57(1));
    (b) On every day in the income year, the total absolute value of all your financial arrangements is NZD1m or less (the absolute value threshold (s EW 57(2)).
29. "Absolute value" is defined in s YA 1 as "the value irrespective of whether the value's sign is positive or negative". This means that the absolute values for a $100,000 loan and a $100,000 cash term deposit are both $100,000 even though one is a liability (-$100,000) and the other is an asset (+$100,000).
30. When applying the above two thresholds, you must include **all** financial arrangements (excluding excepted financial arrangements) that you are a party to, whether as a borrower or a lender. For example, any New Zealand dollar (NZD) home loans and NZD term deposits will generally be financial arrangements, so you need to include them when applying the above thresholds.

31. You do not need to include excepted financial arrangements when applying the above two thresholds, because they are not treated as financial arrangements for the purposes of the FA rules.

32. If you **exceed** the income and expenditure threshold, **and** the absolute value threshold, you will be a non-cash basis person for that income year. The implications of being a non-cash basis person are discussed from [40].

33. If you are under the income and expenditure threshold and/or the absolute value threshold, you then need to apply the second step of the cash basis person test.

Second step in the cash basis person test – deferral threshold

34. The second step of the cash basis person test requires you to consider the deferral threshold (s EW 57(3)). The deferral threshold involves a comparison of your financial arrangement income and expenditure from all your financial arrangements, when calculated on a cash basis, with what your financial arrangement income and expenditure would be from all your financial arrangements, when calculated on a non-cash basis. The following formula at s EW 57(4) is used:

    (accrual income – cash basis income) + (cash basis expenditure – accrual expenditure)

35. You must apply this formula to each financial arrangement you are a party to at the end of the income year, and add the outcomes together. If the total is more than NZD40,000 you will be a non-cash basis person for that income year. Otherwise, you remain a cash basis person.

Annual monitoring of cash basis status important

36. If you have a large foreign currency loan, then even small changes in foreign exchange rates could result in you exceeding the deferral threshold. Alternatively, significant changes in the value of the New Zealand dollar, as seen during the Global Financial Crisis, could result in the threshold being exceeded on smaller loan amounts. Therefore, it is important that you monitor annually whether you still meet the requirements to be a cash basis person.

Cash basis person may use a spreading method

37. A cash basis person may elect to calculate their financial arrangement income or expenditure for each income year of their foreign currency loan term using a spreading method.

38. If you are a cash basis person and you make this election, then the FA rules discussed from [40] will apply as if you were a non-cash basis person.

Cash basis adjustment required if status changes

39. If your status changes from cash basis to non-cash basis or from non-cash basis to a cash basis, you must make a cash basis adjustment under s EW 63. The details of this calculation are beyond the scope of this item.

> **Example 2: Cash basis person**
>
> Xavier is a New Zealand tax resident. He recently purchased a property in southern France that he uses as a holiday home six months of the year. For the other six months of the year, the property is listed for rent on a short-stay accommodation website.
>
> Xavier financed the purchase of the property with a €300,000 loan from a French bank. When converted, the value of the loan is less than NZD550,000. Xavier also has a NZD100,000 loan for his New Zealand home. Xavier is not party to any other financial arrangements and is under the deferral threshold (s EW 57(3)) at all relevant times. Therefore, Xavier is a cash basis person, and is required only to calculate a base price adjustment if an event triggering such a calculation occurs. In Xavier's case, the repayment of his French loan (whether by Xavier directly or through refinancing) is the most likely event that would trigger a base price adjustment. Base price adjustments are discussed from[51].

Non-cash basis persons

40. If you are a non-cash basis person with a foreign currency loan, the FA rules require you to apply a spreading method to calculate the income or expenditure derived or incurred in relation to the loan. A spreading method must be applied for each income year for the term of the arrangement, except for the income year in which a BPA is required.

41. The relevant spreading method to be applied to foreign currency loans is the determination method (s EW 20). The determination we are focusing on in this item is *Determination G9A: Financial arrangements that are denominated in a currency or commodity other than New Zealand dollar* (Inland Revenue, 1990). Instead of Determination G9A, it is possible to apply *Determination G9C: Financial arrangements that are denominated in a currency other than New Zealand dollars: an expected value approach* (Inland Revenue, 2004). However, practical issues around obtaining suitable forward currency

rates as required under Determination G9C mean the determination is not ordinarily used in relation to long-term home loans. For this reason, we do not cover Determination G9C in this item.

42. Determination G9A applies:

> where it is necessary to calculate the income or expenditure of a person in respect of a financial arrangement and any right or obligation of the person in relation to the financial arrangement is fixed or otherwise determined in a currency or commodity other than New Zealand dollars (NZD) and is not fixed in NZD.

43. A cash-basis person does not have to use Determination G9A (or any other determination) unless they have elected to calculate their financial arrangement income or expenditure for each income year of their foreign currency loan term using a spreading method.

44. Determination G9A provides:

> The income or expenditure of the person in respect of a financial arrangement and an income year shall be calculated in accordance with the following formula:
>
> a + b – c – d
>
> where—
>
> a = the value in NZD of the closing tax book value; and
>
> b = the sum of the value in NZD of all consideration given during the income year to or for the benefit of the person in relation to the financial arrangement; and
>
> c = the value in NZD of the opening tax book value; and
>
> d = the sum of the value in NZD of all consideration given during the income year by or on behalf of the person in relation to the financial arrangement—
>
> and the amount so calculated shall,—
>
> (a) Where it is a positive amount be deemed to be income derived by the person in the income year:
>
> (b) Where it is a negative amount be deemed to be expenditure incurred by the person in the income year.

Closing tax book value

45. To calculate the above formula, it is necessary to work out the closing tax book value. Determination G9A provides a second formula to do so:

> "Closing tax book value", in relation to an income year means the value of a person's rights and obligations under a financial arrangement, calculated in accordance with the following formula:
>
> e + f + g – h – i
>
> where—
>
> e is—
>
> (i) Where the person was a party to the financial arrangement at the beginning of the income year, the opening tax book value of the person's rights and obligations under the financial arrangement; and
>
> (ii) In every other case, nil; and
>
> f is the sum of the value (expressed in the base currency in relation to the financial arrangement) of all consideration given during the income year by or on behalf of the person in relation to the financial arrangement; and
>
> g is the base currency income of the person in respect of the financial arrangement; and
>
> h is the sum of the value (expressed in the base currency in relation to the financial arrangement) of all consideration given during the income year to or for the benefit of the person in relation to the financial arrangement; and
>
> i is the base currency expenditure of the person in relation to the financial arrangement:

46. The opening tax book value referred to in the explanation of "e", is defined in Determination G9A as:

> "Opening tax book value", in relation to an income year and the rights and obligations of a person under a financial arrangement, means the closing tax book value of the person's rights and obligations under the financial arrangement at the end of the last preceding income year:

47. Accordingly, the first year in which you apply Determination G9A, the opening tax book value will always be zero. For all following years, the opening tax book value will be the same as the closing tax book value from the previous year.

Currency conversion

48. Note that the amounts in the formula "a + b – c – d" are expressed in New Zealand dollars and the amounts in the formula "e + f + g – h – i" are expressed in the foreign currency the loan is denominated in (the "base currency"). Therefore, it is necessary to convert the foreign currency amounts borrowed and repaid into New Zealand dollars.

49. For the purposes of Determination G9A, *Determination G6D: Foreign currency rates* (Inland Revenue, 1990) sets out the relevant methods and sources of rates information to be used when converting foreign currency amounts into New Zealand dollars.

Applying Determination G9A

50. The simplest way to understand how Determination G9A applies to a foreign currency loan is by way of a worked example. This is done in Example 4 after [73], which applies Determination G9A and includes a BPA calculation.

Calculating a base price adjustment

51. Regardless of whether you are a cash basis person or a non-cash basis person, if you have a foreign currency loan that is a financial arrangement, you will likely be required to calculate a BPA if certain events occur.

When a base price adjustment calculation is triggered

52. Section EW 29 sets out when BPA calculations are required. Common events that will trigger a BPA for your foreign currency loan are that:
    - you cease to be a New Zealand tax resident; or
    - your foreign currency loan "matures".

Ceasing to be a New Zealand tax resident

53. If you cease to be a New Zealand tax resident, you will generally be required to make a BPA calculation for your foreign currency loan (s EW 29(1)). An exception to this is where you are a "temporary" New Zealand tax resident. Section EW 30(1) provides:

> **EW 30 When calculation of base price adjustment not required**
>
> *Cash basis person who ceases to be temporary New Zealand resident*
>
> (1) A cash basis person who ceases to be a New Zealand resident before the first day of the fourth income year following the income year in which they first became a New Zealand resident does not calculate a base price adjustment for a financial arrangement to which they—
>
> (a) were a party before first becoming a New Zealand resident; and
>
> (b) are a party on the date on which they cease to be a New Zealand resident.

54. To be a temporary New Zealand tax resident under s EW 30, you must:
    (a) be a cash basis person; and
    (b) cease to be a New Zealand tax resident before the first day of the fourth income year (1 April under a standard balance date) in which you became a New Zealand tax resident.

55. Effectively, this allows for a maximum temporary tax residency period of four years, assuming a person became a New Zealand tax resident on 1 April of a particular income year and ceased to be a tax resident on 31 March of the fourth income year after the income year they became a tax resident.

56. A temporary resident, other than a transitional resident, who enters into a financial arrangement during the temporary residency period, is required to calculate a BPA when they cease to be a New Zealand tax resident, even if they continued to hold the arrangement on that date.

57. Similarly, a temporary resident, other than a transitional resident, who entered into a financial arrangement before the temporary residency period, but who exited that arrangement before the end of the temporary residency period will also be required to calculate a BPA on the date they end the arrangement (the date of maturity).

Example 3: Temporary resident

Peter is a cash basis person who became a New Zealand tax resident on 28 August 2016. He has a foreign currency loan that he took out on 27 June 2015.

Peter ceases to be a New Zealand tax resident on 20 February 2020. He still has the foreign currency loan on that date.

Under s EW 30, Peter is a temporary resident because he had the loan before becoming a New Zealand tax resident and he still had it on the date he ceased to be a New Zealand tax resident. Therefore, Peter is not required to calculate a base price adjustment on the loan on 20 February 2020, as he would otherwise need to do under s EW 29(1).

Base price adjustment on maturity of financial arrangement

58. The other common event that will require you to calculate a BPA on your foreign currency loan is the loan reaching maturity (s EW 29(3)).

59. Section YA 1 defines "maturity" in relation to loans as follows:

> **maturity,—**
>
> (a) in the financial arrangements rules, means,—
>
> …
>
> (ii) for any other financial arrangement, the date on which the last payment contingent on the financial arrangement is made:

60. In the ordinary course of a fixed-term loan, the final payment may not be required for up to 30 years after the initial borrowing is advanced. However, a foreign currency loan will mature earlier if the full amount owing under the loan is paid off. Therefore, it is important to be aware that routine refinancing can result in a foreign currency loan maturing, triggering a BPA. For example, if you have a foreign currency loan from Lender A and you refinance with Lender B, your original loan from Lender A will be repaid in full and will mature for the purposes of the FA rules.

61. So that you can calculate a BPA you may need to keep records for longer than the seven-year record keeping period that ordinarily applies for tax purposes.

Base price adjustment formula

62. When a BPA event occurs, s EW 31 sets out how the required BPA is to be calculated:

> **EW 31 Base price adjustment formula**
>
> …
>
> *Formula*
>
> (5) The formula is—
>
> consideration − income + expenditure + amount remitted.
>
> *Definition of items in formula*
>
> (6) The items in the formula are defined in subsections (7) to (11).
>
> *Consideration*
>
> (7) **Consideration** is all consideration that has been paid, and all consideration that is or will be payable, to the person for or under the financial arrangement, minus all consideration that has been paid, and all consideration that is or will be payable, by the person for or under the financial arrangement. For the purposes of this subsection, the following are ignored:
>
> (a) non-contingent fees, if the relevant method is not the IFRS financial reporting method[1] in section EW 15D:
>
> (b) non-integral fees, if the relevant method is—
>
> (i) the IFRS financial reporting method in section EW 15D:
>
> (ii) the modified fair value method in section EW 15G.
>
> *Consideration in particular cases*
>
> (8) If any of sections EW 32 to EW 48, or EZ 52D applies, the consideration referred to in subsection (7) is adjusted under the relevant section.
>
> *Income*
>
> (9) **Income** is—
>
> (a) income derived by the person under the financial arrangement in earlier income years; and
>
> (b) dividends derived by the person from the release of the obligation to repay the amount lent; and
>
> (c) income derived under section CF 2(2) and (3) (Remission of specified suspensory loans).
>
> *Expenditure*
>
> (10) **Expenditure** is expenditure incurred by the person under the financial arrangement in earlier income years.
>
> *Amount remitted*
>
> (11) **Amount remitted**—
>
> (a) is an amount (a **remission**) that is not included in the consideration paid or payable to the person because it has been remitted—
>
> (i) by the person; or
>
> (ii) by law; but
>
> (b) does not include a remission that is self-remission.

[1] IFRS means a New Zealand equivalent to an International Financial Reporting Standard

63. From the perspective of a borrower, the consideration paid or payable "to the person" is everything the borrower has received from the lender; that is, the loan amount advanced by the bank. The consideration paid or payable "by the person" is everything paid to the lender; that is, the principal and interest repayments made to the bank. It may also include fees the borrower is required to pay.

64. As noted above, the simplest way to explain the BPA calculation is by way of a worked example. Example 4 after [73] illustrates both a BPA calculation and the application of Determination G9A.

Income under the financial arrangements rules

65. If applying Determination G9A or making a base price adjustment results in a positive figure, that figure represents an amount of income deemed to have been derived in the relevant income year (ss CC 3, EW 14(3) and EW 31(3)).

66. In the context of a foreign currency loan, if an amount of income is deemed to have been derived by the borrower under the FA rules, it will likely be as a result of a significant increase in the value of the New Zealand dollar.

Expenditure under the financial arrangements rules

67. If applying Determination G9A or making a BPA results in a negative figure, that figure represents an amount of financial arrangement expenditure deemed to have been incurred in the relevant income year. Your deemed expenditure under the FA rules may be more or less than your actual expenditure on the loan, depending on the movement of foreign exchange rates.

68. Where there is a foreign exchange gain, your deemed financial arrangement expenditure will likely be less than your actual expenditure. Where there has been a foreign exchange loss, your deemed financial arrangement expenditure will likely be more than your actual expenditure.

69. Even though this financial arrangement expenditure is deemed to have been incurred under ss EW 13 and EW 31, it is still necessary to consider whether that expenditure is deductible. The relevant deductibility provision is s DB 6.

70. Section DB 6(1)–(3) provides:

> **DB 6 Interest: not capital expenditure**
>
> *Deduction*
>
> (1) A person is allowed a deduction for interest incurred.
>
> *Exclusion*
>
> (2) Subsection (1) does not apply to interest for which a person is denied a deduction under section DB 1.
>
> …
>
> *Link with subpart DA*
>
> (3) This section overrides the capital limitation. The general permission must still be satisfied and the other general limitations still apply.

71. For the purposes of s DB 6, financial arrangement expenditure is treated as "interest" under the definition in s YA 1, which states:

> **interest**,—
>
> …
>
> (c) in sections DB 6 (Interest: not capital expenditure), DB 7 (Interest: most companies need no nexus with income), and DB 8 (Interest: money borrowed to acquire shares in group companies),—
>
> (i) includes expenditure incurred under the financial arrangements rules or the old financial arrangements rules; and
>
> (ii) does not include interest to which section DB 1(1)(e) (Taxes, other than GST, and penalties) applies:

72. Under s DB 6, it is still necessary for the deemed interest expenditure to satisfy the general permission for deductibility (s DA 1). Where the financial arrangement in question is a foreign currency loan used to finance a foreign rental property, the general permission will likely be satisfied because of the nexus between the financial arrangement expenditure incurred and the rental income derived from the property that the loan finances.

73. Residential property deductions are generally "ring-fenced", meaning they can be used only against income from residential property, with any deductions in excess of the income being carried forward to the next income year the taxpayer derives income from residential property. For further information on the residential ring-fencing rules, see "Ring-fencing of residential property deductions", *Tax Information Bulletin* Vol 31, No 8 (September 2019): 53.

Example 4: Base price adjustment calculation and application of Determination G9A

Tim is a New Zealand tax resident, who is not a transitional resident. He has an Australian dollar loan that he uses to finance a residential rental property in Australia. Tim is also a non-cash basis person.

The relevant loan and exchange rate information for Tim's loan is as follows:

Loan amount	AUD1m
Interest rate	6%
Term in years	20
Payments per year	12
Drawdown date	5/04/2018

Tim's loan repayment schedule for year 1 (the 2018/2019 income year) in Australian dollars (AUD) is as follows:

Payment date	Payment AUD	Principal AUD	Interest AUD	Loan balance AUD
5/05/18	7,164.31	2,164.31	5,000.00	997,835.69
5/06/18	7,164.31	2,175.13	4,989.18	995,660.56
5/07/18	7,164.31	2,186.01	4,978.30	993,474.55
5/08/18	7,164.31	2,196.94	4,967.37	991,277.61
5/09/18	7,164.31	2,207.92	4,956.39	989,069.69
5/10/18	7,164.31	2,218.96	4,945.35	986,850.73
5/11/18	7,164.31	2,230.06	4,934.25	984,620.67
5/12/18	7,164.31	2,241.21	4,923.10	982,379.46
5/01/19	7,164.31	2,252.41	4,911.90	980,127.05
5/02/19	7,164.31	2,263.68	4,900.64	977,863.37
5/03/19	7,164.31	2,274.99	4,889.32	975,588.38
TOTALS	78,807.41	24,411.62	54,395.80	

The AUD54,395.80 total interest shown in the loan repayment schedule is calculated on a monthly basis and does not include interest accrued for the 26 days from 6/03/2019 to 31/03/19 which Tim paid on 5/04/19. Determination G9A requires interest to be calculated on a daily basis. Interest calculated on a daily basis for the period 5/04/2018 to 31/03/19 is AUD58,478.41.

Year 1 calculations

First, Tim calculates the closing tax book value (CTBV) of the loan for year 1. The formula in Determination G9A for calculating the CTBV is:

$$e + f + g - h - i = \text{CTBV}$$

When calculating CTBV, all amounts are in AUD (the base currency).

The variables in the CTBV formula are:

- e = Opening tax book value (which is always zero in the first year)
- f = Consideration paid by the person
- g = Accrual income calculated on a default method basis
- h = Consideration paid to the person
- i = Accrual expenditure calculated on a default method basis

Using the above loan amounts, Tim calculates the CTBV as follows:

- e = AUD0.00
- f = AUD78,807.41
- g = AUD0.00
- h = AUD1m
- i = AUD58,478.41

$$0 + 78{,}807.41 + 0 - 1\text{m} - 58{,}478.41 = -979{,}671.00$$

Therefore, the CTBV is –AUD979,671.00.

Having calculated the CTBV for year 1, Tim can calculate the accrued foreign exchange income or loss under Determination G9A. To do this Tim uses the second formula set out in Determination G9A:

a + b − c − d = accrued foreign exchange gain/loss

The variables in the above formula are:

a = CTBV

b = Consideration paid to the person

c = Opening tax book value (which is always zero in the first year)

d = Consideration paid by the person

When applying the second formula, all amounts must be converted into NZD in accordance with Determination G6D. Tim obtains the AUD–NZD spot rates for the dates on which each loan payment was made.

Tim obtained the following rates from the Reserve Bank of New Zealand website and converts the loan repayment schedule for year 1 into NZD as follows.

Payment date	AUD–NZD foreign exchange rate	Payment NZD	Principal NZD	Interest NZD
5/05/18	0.9337	7,673.03	2,317.99	5,355.04
5/06/18	0.9188	7,797.46	2,367.36	5,430.10
5/07/18	0.9163	7,818.74	2,385.69	5,433.05
5/08/18	0.9122	7,853.88	2,408.39	5,445.49
5/09/18	0.9095	7,877.20	2,427.62	5,449.57
5/10/18	0.9164	7,817.89	2,421.39	5,396.50
5/11/18	0.9245	7,749.39	2,412.18	5,337.21
5/12/18	0.9498	7,542.97	2,359.66	5,183.31
5/01/19	0.9463	7,570.87	2,380.23	5,190.63
5/02/19	0.9549	7,502.68	2,370.59	5,132.09
5/03/19	0.9628	7,441.12	2,362.89	5,078.23
Total		**84,645.23**	**26,214.01**	**58,431.22**

Tim also obtains the AUD–NZD spot rate for two additional dates:

- 5/04/2018, being the date on which the loan was drawn down, which is used to calculate the NZD equivalent of the loan amount advanced (consideration paid to the person); and
- 31/3/2019, being the last day of the relevant income year, which is used to calculate the NZD equivalent of the CTBV that Tim calculated in AUD earlier.

Tim uses these additional rates to calculate the NZD equivalent of the loan amount advanced and the NZD equivalent of the CTBV for year 1 as follows.

Date	AUD–NZD foreign exchange rate	NZD amount
5/04/2018	0.9482	1,054,629.82 (AUD1m)
1/03/2019	0.9574	1,023,261.96 (AUD979,671.00)

Using the above amounts that he converted from AUD to NZD, Tim applies the second formula under Determination G9A as follows:

a = −NZD1,023,261.96

b = NZD1,054,629.82

c = NZD0.00

d = NZD84,645.23 (being total loan payments during income year)

Using these amounts, and the second formula under Determination G9A gives:

−1,023,261.96 + 1,054,629.82 − 0 − 84,645.23 = −53,277.37

The −NZD53,277.37 amount includes interest paid and accrued from 5/04/18 to 31/03/19 and foreign exchange gains and losses.

Because –NZD53,277.37 is a negative amount, Tim is deemed to have financial arrangement expenditure under Determination G9A. This expenditure is treated as interest for the purposes of s DB 6. Because the loan is used to finance Tim's foreign residential rental property, this deemed interest amount satisfies the general permission for deductibility under s DA 1. Therefore, Tim is allowed a deduction of NZD53,277.37 in year 1 (the 2018/19 income year).

Base price adjustment calculation in year 2

In year 2 (the 2019/20 tax year), Tim makes two further loan payments on 5/4/2019 and 5/5/2019.

On 5/5/2019, Tim also repays the remaining balance of the loan after refinancing with a new lender at a more favourable interest rate. Because the loan is paid back in full on 5/5/2019, the loan is considered to have matured and a BPA calculation is required. The formula for this calculation is:

consideration – income + expenditure + amount remitted

When applying the BPA formula, Tim must convert all AUD amounts into NZD amounts. The variables in the above formula are:

Consideration	=	All amounts paid to the borrower - all amounts paid by the borrower
Income	=	All income derived by the borrower under the loan in earlier income years
Expenditure	=	All expenditure incurred under the loan in earlier income years
Amount remitted	=	An amount, not included in the consideration because it has been remitted by the person, or by law, but not a self-remission

The additional loan repayments Tim makes in year 2 are as follows (including the conversion of these amounts into NZD amounts):

Payment date	Payment AUD	Principal AUD	Interest AUD	Loan balance AUD	AUD–NZD foreign exchange rate	Payment NZD
5/04/19	7,164.31	2,286.37	4,877.94	973,302.01	0.9486	7,552.51
5/05/19	7,164.31	2,297.80	4,866.51	971,004.21	0.9471	7,564.47
5/05/19	971,004.21	971,004.21	-	0.00	0.9471	1,025,239.37

Using NZD amounts, Tim calculates the BPA on his loan as:

Consideration	=	1,054,629.82 (original loan amount) – (84,645.23 (repayments in year 1) + 15,116.98 (repayments in year 2) + 1,025,239.37 (outstanding principal balance repaid))
Income	=	0.00
Expenditure	=	53,277.37 (year 1 deemed financial arrangement expenditure calculated under Determination G9A)
Amount remitted	=	0.00

Therefore:

–70,371.76 – 0 + 53,277.37 + 0 = -17,094.39

Because –NZD17,094.39 is a negative amount, Tim is treated as having financial arrangement expenditure of NZD17,094.39.

As was the case for his financial arrangement expenditure calculated for year 1 of his loan, Tim is allowed a deduction of NZD17,094.39 in year 2 (the 2019/20 tax year).

References

Subject references

Cash basis person

Financial arrangements rules

Foreign currency loans

Legislative references

Income Tax Act 2007, ss CC 3, DA 1, DB 6, EW 3, EW 4, EW 5, EW 13, EW 14, EW 20, EW 29, EW 30, EW 31, EW 57, EW 63, YA 1 ("absolute value", "interest", "maturity")

Related rulings/statements

Determination G9A: Financial arrangements that are denominated in a currency or commodity other than New Zealand dollar (Inland Revenue, 1989).

Determination G9C: Financial arrangements that are denominated in a currency other than New Zealand dollars: an expected value approach (Inland Revenue, 2004).

Determination G6D: Foreign currency rates (Inland Revenue, 1990).

"Ring-fencing of residential property deductions", *Tax Information Bulletin* Vol 31, No 8 (September 2019): 53.

Interpretation Statement "IS 20/06: Income tax – Tax issues arising from ownership of foreign residential rental property" (July 2020).

COMMISSIONER'S STATEMENT

The purpose of a Commissioner's Statement is to inform taxpayers of the Commissioner's position and the operational approach being adopted on a particular matter. A Commissioner's Statement is not a consultative document.

CS 20/03: NRWT for dividends paid to companies: Administering the new holding period tests in Article 10 of the NZ/Australia DTA (and in agreements with other countries)

The purpose of a Commissioner's Statement is to inform taxpayers of the Commissioner's position and the operational approach being adopted on a particular tax matter. The Statement is not a consultative document.

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

Summary

1. Article 10 of the New Zealand-Australia double tax agreement (the DTA) allows for different rates of non-resident withholding tax (NRWT) to be applied to dividends paid to a company. For a corporate payee, the applicable rate is reduced to five percent or zero percent if the payee holds more than a certain percentage of the voting shares in the payer. Previously, for the zero percent rate, the voting shares had to be held for a specified period (the holding period) prior to the date of declaration of a dividend.
2. With effect from 1 January 2019, Article 8(1) of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the MLI) changed the operation of the holding period requirement that must be met for dividends paid to a corporate payee to qualify for the lower rates. The effect of this change is to introduce a holding period requirement before being able to use the five percent rate and that the holding period requirement for both the five and zero percent rates can be met having regard to share ownership after a dividend is paid as well as before.
3. If a shareholder has not satisfied the holding period requirement when a dividend is paid, but may satisfy the requirement in the future, the question arises as to whether a dividend paid to that shareholder should have NRWT withheld from it at a lower treaty rate of five percent or zero percent or at the ordinary treaty rate of 15 percent, with Inland Revenue providing a refund to bring the NRWT down to five or zero percent once the requirement has been met.
4. The Commissioner's view of the correct practice is that NRWT must be withheld from the dividend at the 15 percent rate, and a refund sought once the test has been satisfied.
5. Where a corporate shareholder has already held the specified percentage of voting shares for 365 days when a dividend is paid, as was the case before the modification by the MLI, the dividend payer may deduct at the appropriate lower rate.
6. These provisions only apply to corporate payees; individuals are not affected by this specific modification made by the MLI.
7. The position outlined in this Statement for the DTA also applies for agreements with other countries where the holding period tests in the MLI apply.

Background

8. The withholding tax provisions in New Zealand's current double tax agreement with Australia (the DTA) came into force on 1 May 2010.
9. Article 10 of the DTA concerns the rates of non-resident withholding tax (NRWT) on trans-Tasman dividends. The treaty provides for the following rates of NRWT:
   (a) The ordinary treaty rate is 15 percent (Article 10(2)(b));
   (b) If a shareholder is a company and holds at least ten percent of the voting power in the company paying the dividends, then the applicable rate is five percent (Article 10(2)(a)); and
   (c) If a shareholder is a company and holds at least 80 percent of the voting power in the company paying the dividends and has held that stake for at least a 12-month period ending on the date that the dividend is declared, then no NRWT would need to be withheld so the applicable rate is effectively zero percent (Article 10(3)).

COMMISSIONER'S STATEMENT

10. To be eligible for the zero rate of NRWT on dividends in Article 10(3), the holding period test described in paragraph (c) above must be satisfied. Because the test requires the dividend payer to look backward only from the date of the dividend declaration ("ending on the date"), whether or not a shareholder meets the test or not will have a definitive answer when the dividend is paid. Allowing self-assessment in this instance is not a problem.

Modification

11. The *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (the Multilateral Instrument or MLI) came into effect for the DTA for withholding taxes on 1 January 2019.
12. Article 8(1) of the MLI pertains to dividends and, given that New Zealand has agreed with Australia to be covered by this Article, introduces a minimum holding period to Article 10(2)(a) of the DTA and modifies the minimum holding period in Article 10(3).
13. The new language for this test following New Zealand and Australia agreeing for Article 10 of the DTA to be covered by Article 8 of the MLI requires the ownership threshold to be met "throughout a 365 day period that includes the day of the payment of the dividends". If a shareholder purchases shares on a given day, is paid a dividend from those shares six months after purchasing them, and then holds the shares for another six months, the shareholder may be eligible for one of the lower treaty rates in Article 10(2)(a) or Article 10(3) of the DTA. The shareholder would have held the shares for a 365-day period that "includes the day of the payment of the dividends", despite the fact that the shareholder had not held the shares for 365 days when the dividend was paid.
14. The situation described in the previous paragraph creates a new question for the payer; should they use an NRWT rate consistent with the eligibility criteria that the shareholder may meet or intends to meet in future but does not meet at the time of the dividend payment, or should they use an NRWT rate consistent with what the shareholder is eligible for at the time of the dividend payment before seeking a refund once they are eligible for a lower rate?

Refund approach

15. The Commissioner's position is that dividend payers in this situation should withhold at the ordinary treaty rate of 15 percent. The payer (or alternatively the payee) can then seek a refund under section RM 8 once the shareholder has satisfied that minimum holding period. If obtained by the dividend payer, this refund can be passed on to the shareholder.
16. The Commissioner considers that payers being required to withhold at 15 percent is the correct legal position in these circumstances. A shareholder who has not met the holding period requirements at the time a dividend was paid does not satisfy the wording of the tests in Article 10 of the DTA as modified or limited by Article 8 of the MLI and so is not eligible for either of the lower rates that require satisfaction of the holding period. The shareholder's expectation that they will satisfy the holding period in future does not override the fact that the shareholding requirements for the lower rates have not been met at the time the dividend is paid.
17. It is also the correct position in terms of policy. The alternative approach in this situation would be to allow, from the start, a payer of a dividend to select a lower treaty rate from the time the dividend is paid. A number of issues have been identified with this anticipatory approach:
    (a) If a payer anticipates the shareholder meeting the minimum holding period test in future and therefore self-assesses at a lower rate in the meantime, but ultimately the shareholder ends up disposing of those shares and never meeting the test, then they or the shareholder would need to make an active decision to pay to the Commissioner the tax owing. This creates a risk of non-compliance, which partly defeats the withholding aspect of NRWT.
    (b) Following on from paragraph (a) above, collecting the money owed (which may be relatively insignificant in itself) may be difficult. The Commissioner would likely seek the underpaid tax from the dividend payer in the first instance, since the shareholder is not in New Zealand. The payer would have a right of indemnity against the shareholder as the beneficial owner of the dividend, but this might be difficult to enforce.
    (c) The payer is the withholder but will not control and may not know the intentions of the payee (the shareholder). This is particularly problematic for payers applying Article 10(2)(a), where a lower treaty rate may be claimed with a shareholding as low as ten percent – for owners of relatively low proportions of total shareholdings, the company is unlikely to know as much about the shareholder's intentions about holding the shares.
    (d) Following on from paragraph (c) above, it is clear that allowing self-assessment would be relatively costly for the purposes of administering Article 10(2)(a). Although it is less of a concern for Article 10(3) (which requires a shareholding of at least 80 percent), it would be preferable to have the same administrative approach for both Article 10(2)(a) and Article 10(3).

18. The Australian Tax Office has put out guidance on its website[1] which states that payers of dividends must withhold at the ordinary treaty rate if the test has not been met by a payee at the time a dividend is paid. If the holding period is subsequently satisfied at a point in time after the dividend payment, the beneficial owner of the dividend (or a representative) may apply for a refund of the amount over-withheld. For consistency in the application of the DTA, it is preferable for New Zealand to take the same approach as Australia does on this issue.
19. Companies in this situation may receive a tax credit for foreign income tax paid at the 15 percent rate of NRWT. If a shareholder (either directly or via the payer) is refunded NRWT upon satisfying the holding period test so that they have only paid five percent or zero percent NRWT, then section LJ 7(2) states that their tax credit claim will need to be adjusted accordingly if that credit has been claimed at 15 percent.
20. If the credit is claimed after the shareholder has assessed their tax liability, section LJ 7(3) states that the shareholder is liable to pay the Commissioner the lesser of the amount of the refund or the amount of New Zealand tax payable on the dividend income.

Examples

21. Example 1 sets out a situation in which a taxpayer would need to engage in the refund process in relation to applying a lower treaty rate when they have not yet met the minimum holding period requirement:

Example 1

AusCo, an Australian corporate resident, purchases 80,000 shares in NZCo, a company that is resident in New Zealand. This purchase represents 80 percent of the voting rights in NZCo and occurs on 30 September 2018. On 31 March 2019, NZCo pays a dividend to its shareholders of 10c per share, which entitles AusCo to an $8,000 dividend. AusCo intends to hold the shares for at least another year, which means it will satisfy the minimum holding period in the future. However, at the time the dividend has been paid, AusCo has only held the shares for six months and therefore has not met the minimum holding period test on the date of payment. NZCo must deduct NRWT at the ordinary treaty rate of 15 percent on 31 March 2019, equal to $1,200.

On 30 September 2019, AusCo has held the shares for 365 days. Based on its ownership rights in NZCo, AusCo will now be eligible for the reduced rate of NRWT of zero percent as set out in Article 10(3). NZCo will need to seek a refund with respect to the NRWT on the March 2019 dividend by completing an IR 386 form to receive the difference between the 15 percent NRWT that it originally paid and the zero percent NRWT that is ultimately liable. Having originally paid 15 percent NRWT equal to $1,200, NZCo receives that full amount as a refund and passes it on to AusCo.

22. The position set out in this Statement does not affect the requirements of any taxpayer who has held a number of shares for at least 365 days when a dividend is paid since they will already be eligible for either of the lower rates. This is illustrated in Example 2:

Example 2

AusCorp, an Australian corporate resident, purchases 1,000 shares in NZCorp, a company that is resident in New Zealand. This purchase represents ten percent of the voting rights in NZCorp and occurs on 31 March 2019. On 31 March 2020, NZCorp pays a dividend to its shareholders of 20c per share, which entitles AusCorp to a $200 dividend. Because AusCorp has held the shares for 365 days by the time the dividend has been paid (and based on its ownership rights in NZCorp), it is eligible for the reduced rate of NRWT of five percent as set out in Article 10(2)(a). NZCorp pays $10 in tax and does not have to engage in the refund process since AusCorp met the minimum holding period test when the dividend was paid.

Application to dividends paid to shareholders in countries other than Australia

23. At the time of writing, New Zealand has agreed to be covered by Article 8 of the MLI with both Mexico and Canada as well. Further, although New Zealand does not have an agreement with China to be covered by Article 8 of the MLI, the MLI's definition of the minimum holding period has been written directly into the New Zealand-China DTA that came into force in 2019. The same approach will be taken with these countries as outlined in this Commissioner's Statement.

[1] **www.ato.gov.au/Business/International-tax-for-business/In-detail/Australian-income-of-foreign-residents/Straddle-holding-period-rule/**

General

24. This Statement provides general guidance to assist taxpayers in meeting their taxpayer obligations. If you have any concerns about compliance with the tax obligations discussed in this Commissioner's Statement, you should discuss the matter with a tax professional or Inland Revenue.

Rhys Brown
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Technical Standards, Legal Services

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 20/01: Can owners of existing residential rental properties claim deductions for costs incurred to meet Healthy Homes standards?

Owners of existing residential rental properties may incur expenditure to meet the Healthy Homes standards.

This Question we've been asked (QWBA) discusses the tax treatment of such expenditure under the Income Tax Act 2007.

Question

Can owners of existing residential rental properties claim income tax deductions for costs incurred to meet Healthy Homes standards?

Answer

Costs of a revenue nature are generally deductible in the income year they are incurred and these may include the costs of:

- repairing items that would otherwise meet the standards if operational or in a reasonable condition;
- minor additions or alterations not involving repairs that do not change the character of the building, such as:
  - some costs of meeting the draught-stopping standards, such as blocking unused chimneys or fireplaces (if sufficiently attached to the building);
  - making mechanical ventilation systems compliant; and
  - some costs of meeting the moisture ingress and drainage standard in respect of ground moisture barriers;
- replacing items on a like-for-like basis in the future where they have previously been treated as part of the building; and
- recordkeeping and providing information in tenancy agreements.

Capital costs will generally result in a deduction for a depreciation loss unless they are for something that is part of the residential rental building. The cost of items that are part of the building are added to the building's cost and depreciated at the same rate as the building. Generally, this is zero percent.

Items that are likely to be part of the building include:

- smoke alarms;
- insulation;
- ducted or multi-unit heat pumps;
- flued fires (wood or gas);
- new or replacement openable windows;
- new exterior doors;
- most extractor fans or rangehoods;
- ground moisture barriers; and
- drainage systems for storm, surface and ground water and drainage of water from roofs.

Key terms

Healthy Homes standards: Minimum requirements for residential rental homes for smoke alarms, heating, insulation, ventilation, draught-stopping, drainage and moisture ingress set by regulation under the Residential Tenancies Act 1986. The regulations were introduced in two stages in 2016 (the **2016 regulations** that applied from 1 July 2019) and 2019 (the **2019 regulations** that will be universally applicable from 1 July 2024).

Low-value asset: An item of property that meets the requirements of s EE 38(1) (generally, one with a cost of not more than $500, $1,000 or $5,000, depending when the asset was purchased) (see footnote to [33]).

Capital costs for some items acquired that are not part of the building will be either:

- depreciated over multiple income years using a rate set out in Depreciation Determination DEP80: *Residential rental property chattels* for assets of that type; or
- depreciated at a rate of 100% in the income year the expenditure is incurred if the item is a "low-value asset".

Items able to be depreciated include:

- electric panel heaters (67% DV or SL);[1]
- some heat pumps (eg, single-split type) (20% DV or 13.5% SL); and
- through-window extractor fans, window stays, door openers and stops, external door draught excluders and some devices for blocking fireplaces or chimneys (if the devices are not sufficiently attached to the building) (40% DV or 30% SL).

Background

1. Owners of residential rental properties are required to make sure their properties meet certain minimum standards. Since 1 July 2019, residential rental properties must have met underfloor and ceiling insulation and smoke alarm standards (see the Residential Tenancies (Smoke Alarms and Insulation) Regulations 2016) (the 2016 regulations). From 1 July 2021, the 2016 regulations will be added to by the Residential Tenancies (Healthy Homes Standards) Regulations 2019 (the 2019 regulations).
2. The 2019 regulations apply progressively when there are changes in tenancies after 1 July 2021 with universal application from 1 July 2024.
3. In this QWBA, references to the "Healthy Homes standards" or the "standards" means the standards made under both the 2016 and 2019 regulations — unless indicated otherwise. This item considers the tax treatment under the Income Tax Act 2007 that may apply to expenditure owners of existing residential rental properties may incur to comply with the Healthy Homes standards.
4. Existing rental properties in this context include the situation where the property is temporarily vacant when the work to meet the standards is undertaken. See example 1 of "IS 12/03: Income tax – deductibility of repairs and maintenance expenditure – general principles", *Tax Information Bulletin* Vol 24, No 7 (August 2012): 68.

Tax treatment

Introduction

5. Whether expenditure is revenue in nature and deductible in the year incurred or capital in nature and depreciable, depends on the specific facts. Expenditure to meet the standards will be capital in nature if the work:
    - results in the reconstruction, replacement or renewal of the whole asset or substantially the whole asset; or
    - goes over and above making good wear and tear (ie, is not a repair) and changes the character of the asset.
6. Conversely, expenditure incurred on work to repair or maintain an asset without reconstructing, replacing or renewing the whole asset, or substantially the whole asset, or without changing its character, will be revenue in nature.
7. Deciding whether expenditure is of a capital or revenue nature requires identifying what the relevant asset is against which the character of the expenditure is then gauged.

Identifying the relevant asset

8. In this context, the Commissioner applies a three-step test to identify whether expenditure has been incurred for an item that is a separate asset or part of a larger asset, in this case, a residential rental building. The test is set out in "IS 10/01: Residential rental properties – depreciation of items of depreciable property", *Tax Information Bulletin* Vol 22, No 4 (May 2010): 16 (at [166]):
    - **Step 1:** Determine whether the item is in some way attached or connected to the building. If so, go to step 2. If not, the item will be a separate asset.
    - **Step 2:** Determine whether the item is an integral part of the residential rental property such that a residential rental property would be considered incomplete or unable to function without the item. If so, the item will be part of the residential rental building. If not, go to step 3.

[1] Diminishing value (DV) and straight line (SL) are two methods for calculating depreciation.

- **Step 3:** Determine whether the item is built-in or attached or connected to the building in such a way that it is part of the "fabric" of the building. If so, the item will be part of the residential rental building. If not, the item will be a separate asset.

Applying the three-step test in the context of Healthy Homes expenditure

Step 1 is almost always met

9. The work required to meet the standards almost always involves something that is attached or connected in some way to the residential rental building. While the degree of attachment may seem minimal in some instances (such as with ground moisture barriers or some insulation in ceiling cavities) there is, in most cases, sufficient connection to the building to satisfy step 1 of the test. Accordingly, in the Commissioner's view, it will almost always be the case that step 1 of the three-step test is met.

Step 2 will be met in most cases

10. Step 2, in the context of a residential rental property looks at what:
    - "makes up the residence as a lettable entity";
    - is "part of the complete entity which must be provided by a landlord, at the very minimum, to a tenant";
    - "is a basic requirement of a leased residential dwelling"; or
    - is "a de facto precondition of the residential leasehold agreement".[2]
11. The Commissioner's view is that applying step 2 requires assessing what features or items comprise the relevant asset. In the context of expenditure incurred to meet the Healthy Homes standards, the Commissioner considers the relevant asset is, in this case, a "residential rental building". This involves considering what would ordinarily meet the concept of a particular type of building, that is, a residential rental building. The ordinary concept of a particular asset can evolve over time under the influence of many factors, one of which may be regulatory change.
12. The Commissioner considers that the requirements currently imposed by the 2016 regulations for smoke alarms and insulation mean these items are now an integral part of the property under step 2 and the residential rental property would be considered incomplete without them.
13. However, this is not the case with the 2019 regulations that are not yet fully in force. Despite this, some of the requirements under the 2019 regulations cover things that are already within the ordinary concept of a residential rental building and, as a result, are integral to the building under step 2. In particular, the ventilation standard's requirements for external opening windows and doors and the moisture ingress and drainage standard's requirements for drainage.[3] The Commissioner considers items such as these would be integral to a residential rental property under step 2, regardless of not yet being required under the 2019 regulations.
14. This means that, in the Commissioner's view, step 2 of the three-step test will be met for much of the work required to meet the Healthy Homes standards. Where step 2 is met, the relevant asset is the residential rental building and step 3 is not applicable.

Step 3 is sometimes applicable

15. Where step 2 is not met, it is necessary to consider step 3. Applying step 3 requires determining whether the item is built-in or attached or connected to the building in such a way that it is part of the "fabric" of the building. Factors such as the nature and degree of attachment, the difficulty involved in the item's removal, and whether there would be any significant damage to the item or the building if the item were removed, are relevant. Step 3 also includes considering whether, once installed, an item has lost its physical distinctness or separateness from the building.
16. This factor is particularly relevant to insulation (whether required under the 2016 or 2019 regulations) and moisture ingress and drainage standard requirements under the 2019 regulations for ground moisture barriers (but not for drainage, gutters, and downpipes that are already considered part of the building under step 2, as mentioned above).
17. If the item is part of the fabric of the residential rental building, the relevant asset to gauge the nature of the costs incurred in meeting the Healthy Homes standards is the building — not the item that the expenditure may involve (for example, a heat pump). However, if the item is not part of the residential rental building the relevant asset against which the nature of the costs is gauged will be the item.

[2] See: *Case 11/97* 97 ATC 173 (AAT) cited in IS 10/01 at [146]–[155].

[3] Some of the 2019 regulation's standards reinforce existing regulations, for instance, regulations 9(1), 11(3), 14 and 15 of the Housing Improvement Regulations 1947.

Nature and extent of the work carried out

18. IS 12/03 explains that after identifying the relevant asset the next step is to consider the nature and extent of the work done to the asset.

19. The nature of the work undertaken to meet the Healthy Homes standards may involve repairing or maintaining existing parts of the building. If so, the expenditure may be revenue in nature on account of being "repairs".

20. However, in the Commissioner's view, the nature of the work is more likely to involve making additions or alterations to the building, rather than repairs.

21. The extent of the addition or alteration work required to meet the standards will not typically extend to the reconstruction, replacement or renewal of the whole residential rental building or substantially the whole building. However, the extent of the work may improve or enhance the building or in some way make it better or different and, hence, alter its character.

22. As mentioned at [5], whether expenditure is revenue or capital in nature depends on the specific facts. Some matters that may help with assessing the nature and extent of the work carried out include:
    - expenditure on some minor additions or alterations that do not involve repairs is likely to be revenue in nature;
    - replacements using modern materials are not necessarily capital in nature; and
    - expenditure that is part of an overall project may be capital in nature.

Expenditure on some minor additions or alterations not involving repairs may be revenue in nature

23. In some cases, expenditure incurred in meeting the Heathy Homes standards will involve some additions or alterations that do not involve repairs to the building that are minor in their extent in terms of the work carried out, its importance and its cost. If so, there is a presumption the work is insufficient to alter the character of the building.

24. This is provided the work is not in relation to something that is considered an integral part of the building under step 2 of the three-step test. Items that are part of the building under step 2 are necessary to complete the building or make it fully functional and therefore alter the character of the building. Thus, the ability to deduct the costs of minor additions or alterations to the residential rental building that do not involve repairs will be limited to where the expenditure relates to something that is only considered part of the building under step 3 of the three-step test.

Repairs using modern materials are not necessarily capital in nature

25. In some situations, work needed to be done to meet the Healthy Homes standards may require replacing one item with another that is made of more modern materials and that is superior in some way.

26. If so, the use of modern materials alone does not necessarily mean the repairs are of a capital nature. This is provided the extent of the use of the new materials is such that the whole asset or substantially the whole asset, is not reconstructed, replaced or renewed or the character of the building changed.

Expenditure that is part of an overall project may be capital in nature

27. Expenditure that may otherwise be revenue in nature can take on a capital nature in some circumstances. This may occur if the work is part of an overall project to reconstruct, replace or renew a whole asset or substantially the whole asset or that changes the asset's character (see IS 12/03 at [185] to [208] and examples 17, 19 and 20).

Depreciation losses for capital expenditure may be deductible

28. Where costs incurred to meet a Healthy Homes standard are capital in nature, the expenditure is treated as either:
    - adding to the capital value of the building and subject to the depreciation treatment applicable to that building; or
    - the cost of an asset that is separate from the building.

Depreciation losses for buildings

29. The depreciation rate for buildings with an estimated useful life of 50 years or more is zero percent, which effectively means no depreciation loss is allowed. Most residential rental properties subject to the standards will be buildings of this type. This means any expenditure incurred to meet the Healthy Homes standards that is treated as adding to the capital value of the building is depreciated at the rate applicable to such buildings (generally, zero percent).

30. Note, this outcome applies even though the costs may involve an item that is listed in a general depreciation rate determination for the residential rental property chattels industry code (see "Depreciation Determination DEP80: Residential rental property chattels", *Tax Information Bulletin* Vol 23, No 10 (December 2011): 6). The fact that an item is listed in a depreciation determination does not make the item separately depreciable.

Depreciation losses for separate assets

31. Capital expenditure incurred on separate assets may give rise to a deduction for a depreciation loss:
    - at a rate of 100% in the income year the expenditure is incurred if the item is a "low-value asset" under s EE 38; or
    - over multiple income years using a rate set out in Depreciation Determination DEP80 for assets of that nature.
32. A "separate asset" in this context means that once the three-step test has been applied, the relevant asset is something other than the residential rental building.

Low-value assets may be depreciated in full

33. Section EE 38 states that the entire cost of a low-value asset may be allowed as a depreciation loss in the year the asset is acquired (ie, depreciation is allowed at the rate of 100%). Generally, a low-value asset is one where the cost is not more than a certain amount.[4] The low-value asset cannot be or become part of any other depreciable property, such as the residential rental building.
34. The deduction allowed under s EE 38 is subject to a number of other conditions, including if the property is one of a group of items acquired at the same time from the same supplier, the total cost of the group does not exceed the relevant amount and:
    - the items would be subject to the same depreciation rate if all were treated as items of depreciable property; or
    - if the items generally are trading stock, the cost of those items not treated solely as trading stock does not exceed the relevant amount.

Separate assets that are not low-value assets are depreciated at rate set by Commissioner

35. For separate assets that are not low-value assets, the relevant annual depreciation rate to be used is found in the Commissioner's determination DEP80.

Future replacement costs may be treated differently than current costs

36. Where the tax treatment in this QWBA has been applied, and as a result, an item has been treated as capital in nature and added to the cost of the residential rental building, any future replacement of that item on a like-for-like basis may then involve a repair of the building. This is because the nature and extent of any future replacement expenditure will be assessed against the building as the relevant asset. Unlike the original expenditure on the item, the replacement expenditure may then be revenue in nature.
37. Conversely, if under the tax treatment in this QWBA, expenditure is treated as being for a separate asset from the building and further expenditure is incurred in the future to replace that asset (on a like-for-like basis or otherwise), the replacement expenditure is more likely to be capital in nature. This is because the nature and extent of the future expenditure is assessed against the item replaced (as the relevant asset) and not the building. However, a deduction for a depreciation loss may be allowed for any remaining undepreciated part of the cost of the original item being replaced (subject to any depreciation recovery income on disposal).

Healthy Homes standards

38. The tax treatment of expenditure incurred to meet specific standards is considered below. In each case, any conclusion that expenditure may be revenue in nature is subject to the proviso that the costs are not incurred as part of an overall capital project.

Smoke alarm standard

39. Smoke alarms required under the 2016 regulations are integral to the building under step 2 of the three-step test, so the relevant asset is the building. Installing new smoke alarms in a residential rental building that did not previously have alarms installed is an addition that changes the character of the building, so is capital in nature.
40. Where smoke alarms that have been treated as part of the building reach the end of their useful lives and are replaced, a repair of the building is involved, so the costs will generally be treated as revenue in nature.

[4] The applicable amount depends on when the property was purchased. For purchases prior to 17 March 2020, the amount is not more than $500. For purchases on or after 17 March 2020 and prior to 17 March 2021, the amount is not more than $5,000. For purchases on or after 17 March 2021, the amount is not more than $1,000.

Insulation standard

41. As mentioned at [12] and [16], insulation will form part of the building under step 2 of the three-step test due to the 2016 regulations or under step 3 due to the insulation losing its physical distinctness from the building, or both. Some insulation may also be sufficiently built-in, attached or connected to the building to be part of the building under step 3 of the test.
42. In the Commissioner's view, this means that the relevant asset is the building. Further, the costs of installing or replacing insulation to meet the standards (whether under the 2016 or 2019 regulations) will alter the character of the building. The costs are capital in nature, added to the capital value of the building and depreciated, in most cases, at the rate of zero percent.
43. In some cases, the insulation installed may be replacing, topping-up or patching existing insulation to restore the insulation to its original state where its original state was enough to meet the insulation standard. If so, the work undertaken is in the nature of a repair, so the expenditure will be revenue in nature and deductible in the income year incurred.
44. The costs of patch replacement of foil insulation may also be revenue in nature and deductible in the income year incurred. The repair or installation of foil insulation in residential buildings is banned under the Building Act 2004 due to the electrocution dangers it poses. Foil insulation can only be replaced with non-electrically conductive insulation, and this may be considered an improvement over the original insulation. However, the use of more modern materials does not necessarily mean the relevant expenditure is capital in nature. In these cases, the expenditure is considered deductible expenditure on repairs and maintenance, provided there is not such extensive use of the alternative material that it is likely to change the character of the building.

Heating standard

45. The Commissioner considers that heat pumps and the other forms of heating sufficient to meet the 2019 regulations are not yet a required feature of all residential rental buildings. Accordingly, at present, a building may be considered complete without these particular heating systems. As such, they are not integral to the building under step 2.
46. In terms of step 3, the type of heating systems required to meet the 2019 regulations appear to vary in their likely degree of attachment or connection to the building. For instance, fixed electric panel heaters may not be attached or connected to the building to such a degree that they form part of the fabric of the building. This means the heaters may be treated as a separate asset from the building for repairs and maintenance and depreciation purposes.
47. The most common residential heat pumps are air source, split-single type, with an external unit and single internal unit that is installed through a wall or window. Again, they may also, in most cases, be considered a separate asset from the building. However, with systems such as ducted or multi-unit heat pumps and flued fires (gas or wood) it may be more likely that these form part of the fabric of the building.
48. Where the expenditure can be treated as the cost of acquiring a separate asset, the expenditure will be capital in nature and may be deducted in full in the year incurred depending on its cost and whether the other terms of s EE 38 are met. Otherwise, the expenditure may result in a depreciation deduction over multiple years that is calculated using the appropriate rate in DEP80. Under DEP80 the depreciation rates that may be relevant are:
    - "Air conditioners and heat pumps (through wall or window type)" – 20% (DV) 13.5% (SL);
    - "Heaters (electric)" – 67% (DV and SL); or
    - "Chattel (default class)" – 40% (DV) 30% (SL).
49. Where the heating system is considered part of the building, the relevant asset will be the building. The expenditure will alter the character of the building and be capital in nature. The costs of the heating system are added to the cost of the building and depreciated at the rate applicable to the building (generally, zero percent).
50. Repairs of any existing heating systems that would otherwise meet the heating standard if operational or in a reasonable condition will be deductible as repairs and maintenance expenditure in the income year incurred.

Ventilation standard

51. The costs most likely to be incurred to meet the ventilation standard (other than repairs to existing items) involve acquiring and installing new items to the building, such as openable external doors and windows or rangehoods and extractor fans that vent to the outdoors. The ventilation requirements in the 2019 regulations are not yet a required feature of all residential rental buildings but, as mentioned at [13], the ventilation standard's requirements for opening doors and windows are considered integral to the building under step 2, regardless of not yet being required under the 2019 regulations.

52. In terms of step 3, the type of additions to the building required to meet the ventilation standards (such as, most externally-venting extractor fans) will usually be attached or connected to the building to such a degree that they are considered part of the fabric of the building.
53. An exception may be where a single extractor fan is installed through a window and removal of the fan involves little more than the replacement of the windowpane. In that case, the relevant asset is the fan and its purchase and installation costs may be depreciated at a rate set by the Commissioner (the default chattel rate of 40% DV or 30% SL) unless claimed under the low-value asset option provided by s EE 38.
54. Where the ventilation item is considered part of the fabric of the building under step 2 or step 3, the relevant asset will be the building, the expenditure will, generally, alter the character of the building and be capital in nature. The costs of the item are added to the cost of the building and depreciated at the rate applicable to the building (generally, zero percent).
55. Repairs of existing ventilation items that would otherwise meet the ventilation standard if operational or in a reasonable condition will be deductible as repairs and maintenance expenditure in the income year incurred. However, replacing fixed windows that are otherwise not in need of replacement with opening windows to meet the ventilation standard would not involve a repair. Repairs or minor alterations or additions may also be needed for extractor fans to make sure they are vented correctly according to the 2019 regulations.
56. Under the ventilation standard, existing windows or doors must be able to remain fixed in an open position during normal occupation of the building. This may require work being undertaken to add or alter doors or windows to fit door openers or stops or window stays. These are required under the 2019 regulations and would not at present be considered integral to the building, nor are they likely to have lost their separate identity or have become part of the fabric of the building under step 3. This means the relevant asset currently is likely to be the window stay, door opener or stop, rather than the building and the costs capital in nature. If so, the costs may able to be deducted under the low-value asset provision of s EE 38, should it apply in the particular circumstances.

Moisture ingress and drainage standards

57. Other than repairs, the costs likely to fall into this category are costs to install new:
    - ground moisture barriers;
    - drainage to efficiently drain storm water, surface water and ground water to an appropriate outfall; or
    - gutters, downpipes and drains for the removal of water from roofs.
58. As mentioned at [13] and [16] most items required for the moisture ingress and drainage standards will be either integral to the building under step 2 (for the drainage requirements) or part of the fabric of the building under step 3 (for ground moisture barriers).
59. Accordingly, the relevant asset for most expenditure incurred to meet the moisture ingress or drainage standards will be the residential rental building. Unless the work undertaken is a minor addition or alteration that is not a repair and specifically relates to ground moisture barriers, any other costs of meeting this standard will alter the character of the building, are added to the capital cost of the building and depreciated, in most cases, at the rate of zero percent.
60. Where expenditure is incurred repairing existing parts of the building that would otherwise meet the standards if these parts were operable or in good condition, the costs are likely to be revenue in nature and deductible in the income year incurred. For example, repairs to existing roofs, gutters, ground moisture barriers or drainage systems.

Draught stopping standard

61. Where the expenditure is for the caulking or sealing of gaps or holes, the relevant asset will be the residential rental building. In most cases, this expenditure will be revenue in nature as repairs or maintenance of the building. The expenditure will be able to be deducted in the income year it is incurred.
62. Where the expenditure is for the fitting of draught excluders to external doors or for blocking an unused fireplace or chimney the relevant asset is likely to be the item itself and not the building. However, there may be some cases where the way in which the blocking device is attached to the building and the extent to which it is attached to the building means the device loses its separate visual identity and cannot be removed without significant damage. If so, the relevant asset is the building under step 3 of the three-step test.
63. Where the relevant asset is the item and not the building the costs are likely to be considered capital in nature and, if not able to be depreciated in full under s EE 38, can be depreciated over multiple years at the default chattel rate (40% DV or 30% SL).

64. Where the relevant asset is the building and the costs are not a minor addition or alteration as discussed above they will be capital in nature and added to the capital value of the building and depreciated in most cases at zero percent. Where the relevant asset is the building but the costs are minor they may be deducted in the year incurred as minor additions or alterations not involving repairs that do not change the character of the building.

Recordkeeping and provision of compliance information in tenancy agreements requirements

65. Costs incurred to meet the requirements to provide compliance information and keep records will be deductible expenditure in the income year incurred. An example would be property management fees charged for providing Healthy Homes compliance services.

Examples

66. The following examples illustrate the income tax treatment of costs incurred to meet the Healthy Homes standards. Unless stated otherwise, the examples assume:

- the work undertaken and the expenses incurred are necessary to meet the Healthy Homes standards; and
- the work carried out is not part of any other work carried out on the property at the same time.

Example 1: Installation of new heat pump – not deductible but depreciable

In June 2021, Ari installs a single split-single type heat pump in the main living area of his residential rental building at a total cost of $2,000.

Ari's heat pump is not built into the building to a significant degree and could be removed without great difficulty without damaging the unit or the building. The expenditure is treated as the capital cost of acquiring an asset separate from the building. As the cost is over $1,000 the low-value asset option under s EE 38 is not available. Ari can claim an annual depreciation loss based on the $2,000 cost price of the heat pump at the rate of 20% (DV) or 13.5% (SL). If the heat pump had been acquired between 17 March 2020 and 17 March 2021, then s EE 38 may have applied to allow a depreciation loss calculated at 100% because the cost is below $5,000.

See also, example 16 (heating/air-conditioning systems) in "IS 10/01: Residential rental properties – depreciation of items of depreciable property", *Tax Information Bulletin* Vol 22, No 4 (May 2010): 16.

Example 2: Installation of new insulation – not deductible

Brenda installs new insulation in the ceiling and floors of her previously uninsulated residential rental building. The relevant asset is the residential rental building under step 2 of the three-step test. The expenditure involves additions to the building that changes its character.

The expenditure is not deductible and is added to the capital value of the residential rental building and depreciated at the rate of zero percent.

This example is based on, and consistent with example 10 (new insulation – improvement that changes character) in "IS 12/03: Income tax – deductibility of repairs and maintenance expenditure – general principles", *Tax Information Bulletin* Vol 24, No 7 (August 2012): 68.

Example 3: Topping up insulation to restore its original condition – deductible

Carlos owns a rental flat with existing ceiling insulation. The tenant has just moved out, but Carlos is actively seeking a new tenant. Carlos obtains advice from a professional installer of insulation who confirms the ceiling insulation has settled over the years since it was installed and, but for this, would have met the insulation standards.

The most efficient solution is to top up the insulation to restore it to its original condition, which is enough to meet the standard. Carlos arranges for the ceiling insulation to be topped up before the flat is let to a new tenant.

The relevant asset is the flat and the work restores the efficiency of the insulation to its former condition. Therefore, the work undertaken is in the nature of a repair. The costs are revenue in nature and can be deducted in the year incurred.

This example is consistent with example 9 (insulation top-up – no change in character or substantial replacement or renewal) in "IS 12/03: Income tax – deductibility of repairs and maintenance expenditure – general principles", *Tax Information Bulletin* Vol 24, No 7 (August 2012): 68.

Example 4: Topping up insulation beyond its original condition – not deductible

Dara owns a rental flat with existing ceiling insulation. Dara obtains advice from a professional installer of insulation who confirms the ceiling insulation is in reasonable condition but does not meet the 2016 or 2019 regulations' insulation standards. The installer's advice is that the most efficient solution is to top up the existing insulation with significantly more insulation.

The relevant asset is the flat under step 2 of the three-step test. The work undertaken adds significantly to the amount of insulation in the ceilings. The nature and extent of the work changes the character of the flat.

The expenditure is not deductible and is added to the capital value of the residential rental building and depreciated at the rate of zero percent.

Example 5: Minor additions and alterations not involving repairs – deductible

Wiremu installs a small area of additional ground moisture barrier to extend the existing moisture barrier ensuring it covers all the underfloor areas of his residential rental property and meets the moisture ingress and drainage standard of the 2019 regulations. The cost is $90.

The relevant asset is the residential rental building under step 3 of the three-step test. The expenditure does not involve repairs, and the moisture barrier is an addition to the property. However, the work undertaken and expenditure is minor so the nature and extent of the expenditure does not change the character of the building.

The expenditure is revenue in nature, so can be deducted in the year incurred.

Example 6: Repairs to insulation using different materials – deductible

Aroha's residential rental building has foil-based underfloor insulation. The insulation under one bedroom is ripped and has deteriorated to the point it is no longer in a reasonable condition. It does not meet the standard set for insulation in the 2016 regulations. The underfloor insulation in other areas of the building is in reasonable condition and meets the standard.

Aroha discovers that it is not possible to repair or replace the foil insulation. This is because the repair or installation of foil insulation in residential buildings poses electrocution dangers and has been banned under the Building Act 2004.

Aroha replaces the damaged insulation with a non-electrically conductive but comparatively performing insulation that meets the insulation standard.

The relevant asset is the residential rental building. The work undertaken is in the nature of a repair that does not change the character of the property.

Using a different insulation material that may be considered better in some respects (for example, safer) does not mean the building is relevantly changed or improved. The new type of insulation does not essentially function differently from the original insulation and has not been used to such an extent that it is likely to change the character of the building.

The costs are revenue in nature, so can be deducted in the year incurred.

References

Subject references

Capital expenditure
Depreciation
Healthy Homes standards
Income tax
Repairs and maintenance
Residential rental chattels

Legislative references

Building Act 2004
Income Tax Act 2007, s EE 38(1)
Housing Improvement Regulations 1947: regs 9(1), 11(3), 14 and 15
Residential Tenancies Act 1986
Residential Tenancies (Healthy Homes Standards) Regulations 2019
Residential Tenancies (Smoke Alarms and Insulation) Regulations 2016

Case references

Case 11/97 97 ATC 173 (AAT)

Other references

"Depreciation Determination DEP80: Residential rental property chattels", *Tax Information Bulletin* Vol 23, No 10 (December 2011): 6

"IS 10/01: Residential rental properties – depreciation of items of depreciable property", *Tax Information Bulletin* Vol 22, No 4 (May 2010): 16

"IS 12/03: Income tax – deductibility of repairs and maintenance expenditure – general principles", *Tax Information Bulletin* Vol 24, No 7 (August 2012): 68

QB 20/02: Income tax – Natural love and affection exception to debt remission income for look-through company

This Question We've Been Asked is relevant to shareholders of a look-through company that has debt forgiven by a close friend or family member of the shareholders.

Key terms

Creditor – a person who lends money

Debt – for example, a loan

Debtor – a person who borrows money

Look-through company – a type of company that is treated like a partnership for tax purposes

Question

Does a look-through company derive debt remission income when a close friend or family member of the shareholders forgives a loan made to the look-through company?

Answer

No. Section EW 46C prevents the look-through company from deriving debt remission income where all of the shareholders and the close friend or family member have natural love and affection for each other.[1]

The Commissioner will generally accept that the shareholders and the close friend or family member have natural love and affection for each other.

Explanation

1. Legislative references are to the Income Tax Act 2007, unless otherwise stated.
2. When debt is forgiven by a creditor, the debtor may derive debt remission income under the financial arrangement's rules (s EW 31 (Base price adjustment formula)). Given the transparent nature of a look-through company (LTC), if debt remission income arises for an LTC it will be taxed in the LTC shareholder's hands (s HB 1).
3. Section EW 46C (Consideration when debt forgiven within economic group) provides for an exception that prevents certain debtors from deriving debt remission income. One situation s EW 46C can apply to is where a LTC derives debt remission income and the creditor and the LTC's shareholders have natural love and affection for each other (s EW 46C(1)(e)).
4. A similar exception applies to partnerships (s EW 46C(1)(d)). While this QWBA does not consider the partnership exception, the conclusions reached in this QWBA are also relevant to partnerships where the creditor of the partnership and all of the partners have natural love and affection for each other.[2]

Debts, debtors and creditors covered by the exception

5. Section EW 46C works by altering the usual position for "debt", "debtor" and "creditor". Relevant to this QWBA, debt, debtor and creditor will be covered by s EW 46C(1)(e) if debt is forgiven and:
   - the debtor is an LTC; and
   - the creditor has an effective look-through interest in the LTC.

Single creditor group

6. The uncertainty addressed in this QWBA arises because the creditor is not the same person as the shareholders of the LTC. This means that, at first glance, the exception applying to debt owed by a creditor with an effective look-through interest in a LTC might not apply.
7. However, a separate rule modifies who the creditor is when applying the exception (s EW 46C(2)(b)). This rule works by treating a group of individuals (a single creditor group) as the creditor, if the following criteria are met:
   - The individuals in the group are either creditors or have interests (including an effective look-through interest) in the LTC or both.
   - Each individual in the group must have natural love and affection for each other individual in the group.
8. Assuming these criteria are met, the shareholders and creditor are together the "creditor" for the purposes of s EW 46C. As creditor, they are treated as holding the total debts and interests of the single creditor group. The deemed consideration rule described at [12] is then applied to the creditor and the LTC as debtor.

[1] This is provided no other debt of the look-through company to which s EW 46C applies is forgiven at the same time.

[2] This is provided no other debt of the partnership to which s EW 46C applies is forgiven at the same time.

Natural love and affection

9. For the single creditor group rule to apply, each individual in the group must have natural love and affection for each other individual in the group. This is the primary test. Natural love and affection is not defined in the Act. However, it will often arise in the context of domestic or family relationships.[3]
10. Natural love and affection will most commonly occur between immediate and extended family members, as well as de-facto partners.[4] It can also exist between close friends, such as life-long friends.[5]
11. The Commissioner will generally accept that there is natural love and affection between family members and close friends.

Deemed consideration for debtor and creditor

12. The way the exception prevents debt remission income from arising is by deeming:
    - the debtor to have paid the amount of debt to the extent that the proportional debt ratio for the debt equals the proportional ownership ratio (s EW 46C(4)(b)); and
    - the creditor to have received payment for the amount of debt to the extent that the proportional debt ratio for the debt equals the proportional ownership ratio (s EW 46C(5)(b)).
13. In both cases, the deemed payment is made on the date the creditor forgives the debt.
14. The proportional debt ratio is the percentage the debt bears to the total amounts of debt owed by the LTC to which s EW 46C applies that are forgiven at the same time (s EW 46C(6)). The proportional ownership ratio is the creditor's percentage of the total effective look-through interests in the LTC (s EW 46C(6)).
15. In this QWBA, the debtor LTC is deemed to have paid the full amount of debt to the creditor. The creditor is deemed to have received payment for the full amount of debt from the LTC. This eliminates any debt remission income for the LTC. This is illustrated in the Example below.

Example

LTC debt forgiven by a brother of the sole shareholder

Jo and James are siblings. Jo, a talented baker, incorporates a company, Jo's Baking Ltd, and becomes the company's sole shareholder. Jo elects for Jo's Baking Ltd to become a LTC.

James is keen to support Jo's business and loans $50,000 to Jo's Baking Ltd.

Unfortunately, Jo's business is unsuccessful, and Jo's Baking Ltd cannot pay back James. James decides to forgive the debt. No other debt is owed by Jo's Baking Ltd and so no other debt to which s EW 46C applies is forgiven at the same time. Therefore, the proportional debt ratio is 100%.

Jo and James have natural love and affection for each other. This means, for s EW 46C purposes, Jo and James together are the "creditor" of the $50,000 loan.

Jo and James together as the single creditor group hold 100% of the debt being forgiven. They also hold 100% of the effective look-through interest in Jo's Baking Ltd, so the proportional ownership ratio is 100%.

Section EW 46C will prevent any debt remission income arising for Jo's Baking Ltd (or Jo as shareholder). This is because s EW 46C(4) and (5) treats Jo's Baking Ltd as having paid back the $50,000 loan to James at the time the debt is forgiven.

References

Subject references

Debt forgiveness
Debt remission income
Income tax
Look-though company
Natural love and affection

Legislative references

Income Tax Act 2007, ss EW 31, EW 46C, HB 1, YA 1 ("look-through interest")

Case references

Byrne v Bishop [2001] 3 NZLR 780
Director of Public Prosecutions (Vic) v Le [2007] HCA 52
Fisher v Kirby [2013] NZFLR 463
PH v GH [2013] NZFLR 387
Rumford Estate (Re), [1996] O.J. No.3484
Taylor v Commissioner of Stamp Duties [1924] NZLR 499

[3] *Director of Public Prosecutions (Vic) v Le* [2007] HCA 52 at [48].

[4] See, for example, *PH v GH* [2013] NZFLR 387, *Taylor v Commissioner of Stamp Duties* [1924] NZLR 499, *Byrne v Bishop* [2001] 3 NZLR 780.

[5] See, for example, *Fisher v Kirby* [2013] NZFLR 463 and *Rumford Estate (Re)*, [1996] O.J. No.3484.

LEGAL DECISIONS – CASE SUMMARIES

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.

CSUM 20/06: AB Limited and Y Z Limited v Commissioner of Inland Revenue

Case	TRA 002/19 and TRA006/19 [2020] NZTRA 1
Decision date	5 June 2020
Legislative References	Tax Administration Act 1994, s 89K(4)
Legal terms	n/a

Summary

The disputants, AB Limited ("ABL") and Y Z Limited ("YZL") were parties to tax arrangements known as the Russell template devised by the late John George Russell. The Commissioner of Inland Revenue ("the Commissioner") issued a refusal notice to each disputant under s 89K(4) of the Tax Administration Act 1994 ("the TAA") refusing to accept late notices of proposed adjustment ("NOPAs") as having been given within the applicable response period under Part 4A of the TAA. Both disputants have issued proceedings challenging the Commissioner's decision and the proceeded on the basis that the challenges are viewed as test cases for claims by other companies in the Russell template.

Facts

The disputants asserted that they wrongly paid GST to the Commissioner in the late 1980s/early to mid-1990s. The amounts claimed to have been wrongly paid by ABL total $136,670.62 while the amounts claimed by YZL total $720,893.01. If successful in these proceedings, the disputants propose to seek repayment of these amounts. The disputants, in principle relied on the on events relating to other taxpayers, most particularly FB Duvall as a justification for not filing objections prior to the judicial review proceeding.

Issues

The issue for determination was confined to whether the criteria set out in s 89K have been satisfied so that the late NOPAs can be treated as having been given within the applicable response period.

Decision

The Taxation Review Authority ("The Authority") found that:

- judicial review proceedings relating to other taxpayers does not provide an exceptional circumstance preventing ABL and YZL from issuing a NOPA's; and
- even if ABL and YZL had been able to establish an exceptional circumstance as alleged, the NOPA's was not filed as soon as reasonably practicable after the disputants became aware of its failure to issue an objection/NOPA within the applicable response period.

For the reasons discussed above, the Authority found that ABL and YZL have failed to satisfy the requirements of s 89K of the TAA.

About this document

These are brief case summaries, prepared by Inland Revenue, of decisions made by the Taxation Review Authority, the District Court, the High Court, the Court of Appeal or the Supreme Court in matters involving the Revenue Acts. For Taxation Review Authority matters, names have been anonymized. The findings of the court described in a case summary will no longer represent current law where the matter has been successfully appealed or subsequent amended legislation has been enacted.

CSUM 20/07: Company restored to the Register and Commissioner of Inland Revenue granted an extension to issue Challenge Notice

Case	Commissioner of Inland Revenue v Waheedullah Faghriyar and Attorney General on behalf of the Registrar of Companies [2020] NZHC 1256
Decision date	12 June 2020
Legislative References	Companies Act 1993 ("CA"), s329 Tax Administration Act 1994 ("TAA"), Part 4A ss 89D, 89G, 89K, 89L, and 89P.
Legal terms	Restoration of company, undischarged claim, challenge notice extension, exceptional circumstances

Summary

The First Respondent, Waheedullah Faghriyar, and the company Discount Tyres and Mechanical Services Limited ("Discount Tyres") initiated the statutory disputes procedure under Part 4A of the TAA ("the dispute") with the Commissioner of Inland Revenue ("the Commissioner") while a criminal prosecution against the First Respondent ("the criminal case") was already on foot. The Commissioner held the dispute in abeyance until the criminal case was concluded in order to protect the First Respondent's fair trial rights causing an approximately two-year delay before the dispute could be restarted. Due to the delay, the Commissioner would not be able to issue a challenge notice concluding the dispute within the statutory time bar of four years. While the criminal case was on foot Discount Tyres was struck off the Companies Register ("the Register").

Accordingly, the Commissioner applied under section 329 of the CA for Discount Tyres to be reinstated on the Register and under section 89L(1B) of the TAA to extend the time for issuing a challenge notice past the four-year time bar. The Commissioner's applications were not opposed and were granted by the Court.

Impact

This decision is significant to the Commissioner because it shows that the Court accepts that an "undischarged claim" covers the Commissioner merely having a dispute under Part 4A of the TAA, meaning the Commissioner can apply to restore a struck off company to the Register even in circumstances where she has not yet filed legal proceedings with the Courts but has a statutory claim to recover unpaid tax.

This decision is also significant because it shows that the Court has upheld the Commissioner's recently adopted approach of delaying civil disputes while criminal proceedings remain extant in to protect a defendant's fair trial rights in those criminal proceedings as constituting an "exceptional circumstance" under section 89K of the TAA.

Facts

The First Respondent was the sole shareholder and director of Discount Tyres. After the First Respondent and Discount Tyres failed to file income and GST returns between the 2008 to 2015 years, the Commissioner issued default assessments.

On 12 February 2016, the First Respondent and Discount Tyres initiated the dispute by issuing notice of proposed adjustments ("NOPA") to the Commissioner's default assessments. This was followed by the Commissioner issuing notices of response ("NOR"). The First Respondent and Discount Tyres rejected the Commissioner's NOR.

The criminal case was on foot when the First Respondent and Discount Tyres initiated the dispute. The Commissioner held the dispute in abeyance for the period between 24 May 2016 to 14 December 2018 when the criminal case had concluded.

On 8 July 2016, Discount Tyres was struck off the Register while the criminal case was in progress.

The dispute recommenced with two facilitated conferences being held on 19 May 2019 and 16 August 2019. The facilitated conference stage was not concluded. The Commissioner filed this application before the four-year time bar expired on 11 February 2020.

Issues

The key issues the Court needed to decide in order to grant these orders were whether:

- Any grounds are met under section 329 of the CA allowing the Court to use their discretion to restore a company to the Register;
- It was appropriate to bring a section 89L(1B) of the TAA application to the Court by way of originating application;
- The Commissioner has applied for an extension to issue a challenge notice after the expiration of the four-year time bar within the four-year time bar;
- The Commissioner's decision to hold the dispute in abeyance causing delay amounted to "exceptional circumstances" warranting an extension to the four-year time bar pursuant to section 89P of the TAA.

Decision

Restoration application

The Court granted the Commissioner's application to restore Discount Tyres to the Register.

The Court held that the Commissioner had an undischarged claim against Discount Tyres for unpaid income tax and GST as a result of her issuing default assessments. Accordingly, it was not necessary for the Court to determine the alternative ground for restoration, namely the "just and equitable" ground. Even if the Court was required to consider this ground, the Court held it would be equally "just and equitable" to grant the restoration order sought.

The Court accepted that an undischarged claim included an incomplete dispute under Part 4A of the TAA.

The Court held that a person who has a contestable claim against a company but who has not yet started proceedings has standing and a ground to apply for restoration on the basis that they have an undischarged claim against the company.

Leave to commence originating application

The Court granted the Commissioner's application to commence an application under section 89L(1B) of the TAA by originating application.

Extension to section 89P four-year time bar

The Court granted the Commissioner's application to issue challenge notices to the First Respondent and Discount Tyres beyond the four-year time bar under section 89P of the TAA.

The Court accepted that the Commissioner filed the application within the four-year time bar period.

The Court concluded that the dispute being held in abeyance for approximately two and a half years to protect the First Respondent's fair trial rights in criminal proceedings amounted to "exceptional circumstances" pursuant to the definition in section 89L(3) of the TAA.

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The Tax Counsel Office (TCO) 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 TCO 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 Services

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

Technical Standards

Technical Standards sits within Legal Services and contributes 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. Technical Standards also contributes 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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