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TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

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YOUR OPPORTUNITY TO COMMENT

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

You can find a list of the items we are currently inviting submissions on as well as a list of expired items at **www.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

Orders in Council

LI 2021/137 - Tax Administration (Canterbury Flood Event) Order 2021 3

This order, which comes into force on its notification in the Gazette, declares the Canterbury Flood Event to be an emergency event for the purpose of section 183ABA of the Tax Administration Act 1994. The order expires and is revoked on 31 August 2021.

LI 2021/154 – Income Tax (Deemed Rate of Return on Attributing Interests in Foreign Investment Funds, 2020–21 Income Year) Order 2021 3

This order sets, for the 2020–21 income year, the deemed rate of return used to calculate foreign investment fund income under the deemed rate of return calculation method set out in section EX 55 of the Income Tax Act 2007.

LI 2021/166 – Covid-19 Resurgence Support Payments Scheme (July 2021) Order 2021 3

This order, which comes into force on 1 July 2021, activates the COVID-19 resurgence support payments scheme (the CRSP scheme).

Ruling

BR Pub 21/03: Goods and services tax – debt factoring arrangements 5

This public ruling considers whether a GST input tax deduction can be claimed for a bad debt write-off when a debt is factored.

Withdrawal notice for BR Pub 06/01 12

This notice withdraws BR Pub 06/01 from 9 August 2021.

Operational statement

OS 21/02: Administration of the imported mismatch rule – section FH 11 13

This statement is intended to clarify the Commissioner's expectations as to how taxpayers will meet their self-assessment obligations when applying the imported hybrid mismatch rule in s FH 11 of the Income Tax Act 2007 to payments to members of their control group, and how the rule will be administered by Inland Revenue in relation to such payments.

Interpretation statements

IS 21/05: Non-cash dividends 16

This interpretation statement considers when a transfer of company value from a company to a shareholder is treated as a dividend for tax purposes. It focuses on the types of non-cash transactions that are often entered into between small and medium-sized companies and their shareholders.

IS 21/06: Income tax and GST – treatment of meal expenses 30

This statement covers the income tax and GST treatment of meal expenses incurred by self-employed persons. It also discusses the treatment of meal allowances paid to employees to illustrate the differences with the treatment of self-employed persons, and the treatment of entertainment expenditure for the same reason.

IN SUMMARY (continued)

Questions we've been asked

QB 21/05: The application date for the depreciation of commercial buildings 49
This question we've been asked clarifies when the new rules providing for the depreciation of commercial buildings apply from.

QB 21/06: Income tax - tax treatment of cryptoassets received from an airdrop 51
This item addresses the income tax consequences of receiving cryptoassets from an airdrop.

QB 21/07: Income tax - tax treatment of cryptoassets received from a hard fork 57
This item addresses the income tax consequences of receiving cryptoassets from a fork.

QB 21/08: GST - How do the compulsory zero-rating of land rules apply to transactions involving commercial leases? 64
Section 11(8D) of the Goods and Services Tax Act 1985 contains the compulsory zero-rating of land rules for commercial leases. This question we've been asked explains how s 11(8D) operates.

Determination

DEP107 - General tax depreciation rates for brake test rollers 70
This determination sets depreciation rates for brake test rollers used in the ordinary course of business.

NEW LEGISLATION

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

Tax Administration (Canterbury Flood Event) Order 2021

The flooding created by the heavy rain that fell in Canterbury region between 29 May and 1 June 2021 has been declared to be an emergency event for the purposes of section 183ABA of the Tax Administration Act 1994. This section allows the Commissioner to remit use-of-money interest payable on late tax payments following emergency events.

The declaration applies to taxpayers who were physically prevented from paying their tax on time as a result of the floods. The declaration commenced 8 June 2021 and expires 31 August 2021.

Taxpayers may apply for remission once their tax returns and payments are up to date. Different rules apply in cases of financial hardship.

Find out more about Inland Revenue's tax relief measures at **www.ird.govt.nz** *Tax Administration (Canterbury Flood Event) Order 2021*

Income Tax (Deemed Rate of Return on Attributing Interests in foreign Investment Funds, 2020–21 Income Year) Order 2021

The deemed rate of return for taxing interests in foreign investment funds is 4.43% for the 2020–21 income year, down from 5.05% for the previous income year.

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.

The new rate was set by Order in Council on 14 June 2021 and came into force on 18 June 2021.

COVID-19 Resurgence Support Payments Scheme (July 2021) Order 2021

The COVID-19 Resurgence Support Payments Scheme (July 2021) Order 2021 came into force on 1 July 2021. This Order activated the COVID-19 Resurgence Support Payments Scheme.

Background

Section 7AAB of the Tax Administration Act 1994 (the TAA) authorises the Commissioner of Inland Revenue (the Commissioner) to make grants under the COVID-19 Resurgence Support Payments Scheme (the Scheme) if there is a period of raised COVID-19 alert levels anywhere in New Zealand. In general, the Scheme will be activated when there is a period of 7 days or more at the raised alert levels. The intention of the Scheme is to provide for grants to be made to support businesses with expenses such as wages and fixed costs when there is an escalation in COVID-19 alert levels and a resulting reduction in revenue.

Section 7AAC of the TAA is an empowering provision for the making of an Order in Council activating the Scheme, and determining the class of persons who can apply for the Scheme and the payment amount. A person may be eligible for a one-off payment each time the Scheme is activated.

On 23 June 2021, COVID-19 alert levels in the Greater Wellington region were raised to level 2. This escalation lasted 7 days, triggering the activation of the Scheme. The Greater Wellington region returned to alert level 1 at 11:59pm on 29 June 2021. The COVID-19 Resurgence Support Payments Scheme (July 2021) Order 2021 (the Order) came into force on 1 July 2021 activating the Scheme.

The July Order continues the Scheme until 29 July 2021, which is the first working day that is at least one month after the Greater Wellington region returned to alert level 1.

Class of persons covered

The Order sets out the class of persons eligible for a grant.

An eligible person must be one of:

- an individual who is self-employed
- a body corporate or an unincorporated body
- a registered charity
- an incorporated society
- a post-settlement governance entity
- a trust
- a partnership (as defined in sections 8 and 9 of the Partnership Law Act 2019)
- any department or organisation in the State services (as defined in section 5 of the Public Service Act 2020) that is approved by the Minister of Finance as a participant in the Scheme
- a non-government organisation
- a pre-revenue firm; or
- a joint venture.

The person must be living in New Zealand, or if a non-natural person, registered or otherwise established in New Zealand. The person may be entitled to receive a grant of money under the Scheme if they experience a minimum 30% revenue decline when comparing a consecutive 7-day period that reflects the typical revenue for that business in the six weeks prior to the escalation in alert levels with a consecutive 7-day period that anywhere in New Zealand was at alert level 2 or above. The person must apply this revenue decline test in accordance with the eligibility criteria set by the Commissioner. If the person is part of a commonly owned group this 30% decrease also needs to be satisfied across the group as a whole. In previous activations of the Scheme, commonly owned groups made one group application. In respect of the July activation, the Order allows individual group members to apply provided the eligibility criteria are satisfied. The person and the commonly owned group must use the same date ranges for their affected revenue and comparator periods In this context, commonly owned group has the meaning described in eligibility criteria set by the Commissioner (**https://www.ird.govt.nz/covid-19/business-and-organisations/resurgence-support-payment/eligibility**).

To qualify for a grant under the Order, the 7-day period used to demonstrate a decline in revenue must be between 23 June to 29 June 2021 (both dates inclusive).

Further eligibility requirements have been set out by the Commissioner under section 7AAB(3) of the TAA and are published on the Inland Revenue website
https://www.ird.govt.nz/covid-19/business-and-organisations/resurgence-support-payment/eligibility.

Amount of the grant

The Order sets out the amount of the payment that a person will be entitled to as the lesser of:

- $1,500 plus $400 for each full-time equivalent worker employed by the person (up to a maximum of 50 full-time equivalent workers); or
- 4 times the amount by which the eligible person's revenue has declined.

Applications

Applications in response to the COVID-19 alert level escalation opened on 1 July 2021 and may be submitted via MyIR until 11:59pm on 29 July 2021. Further procedural requirements in relation to the making of an application have been set out by the Commissioner under section 7AAB(3) of the Tax Administration Act 1994 and are published on the Inland Revenue website **https://www.ird.govt.nz/covid-19/business-and-organisations/resurgence-support-payment/apply**.

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 21/03: Goods and services tax – debt factoring arrangements

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

Taxation laws

This Ruling applies in respect of ss 20(3)(i) and 26.

The arrangement to which this Ruling applies

The arrangement is the sale, by a GST registered person (the Assignor), to a third party (the Factor), on a recourse or non-recourse basis, of an outstanding debt at a price less than the debt's face value.

How the taxation laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- The difference between the face value of the debt and the price received from the Factor is not a bad debt for the purposes of s 26. Accordingly, s 26 has no application and the registered person cannot claim an input tax deduction under s 20(3)(i); and
- If a portion of a debt is written-off before it is sold to the Factor, then whether this write-off meets the requirements of s 26(1) depends on whether the amount written off was "bad" according to the conventional tests as outlined in Public Ruling "BR Pub 18/07: Income tax and goods and services tax – writing off debts as bad" *Tax Information Bulletin* Vol 30, No 9 (October 2018) (BR Pub 18/07).

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 10 August 2021.

This Ruling is signed by me on 17 June 2021.

Susan Price

Group Leader, Public Advice and Guidance

Tax Counsel Office

Commentary on Public Ruling BR Pub 21/03

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 21/03 ("the Ruling").

Summary

1. When a registered person factors a debt owing for less than its face value, the issue arises whether the difference between the face value of the debt and the amount received from the Factor can be an amount "written off as a bad debt" under s 26(1).
2. The Commissioner considers that the difference between the face value of the debt and the amount received from the Factor cannot be an amount written off as a bad debt under s 26(1) and consequently no deduction from output tax can be claimed under s 20(3)(i). Rather than being a bad debt, the discount from face value is simply a result of the process of agreeing the consideration for the debt that is acceptable to both the Assignor and the Factor.
3. Whether a debt is written off as "bad" under s 26(1) depends on the application of the tests outlined in BR Pub 18/07.

Background

4. BR Pub 21/03 is a reissue of BR Pub 06/01. This Ruling is essentially the same as BR Pub 06/01, which applied indefinitely from 1 August 2005. BR Pub 06/01 is withdrawn and this Ruling is reissued with updated legislative references and a refreshed commentary.
5. Sections 26 and 20(3)(i) of the GSTA allow a registered person to make a deduction from output tax if the registered person has made a taxable supply, returned output tax in respect of that taxable supply, and subsequently written off as a bad debt, all or part of the debt.
6. If a registered person factors (i.e. sells) a debt owing for less than its face value to a third party (the Factor), the issue arises whether the difference between the face value of the debt and the amount received from the Factor can be an amount written off as a bad debt.
7. A debt can be factored either on a recourse basis or on a non-recourse basis. Debt factoring on a non-recourse basis means that the Factor has no claim back to the Assignor if the debts sold to them become doubtful or uncollectable (i.e. the Factor assumes all of the risk). In contrast, debt factoring on a recourse basis means that the Factor has some form of claim back to the Assignor if the debts sold to them prove to be doubtful or uncollectible.
8. Historically, debt factoring was dealt with in PIB No 164 (August 1987) "GST and debt collection agencies – debt factoring" and in Technical Rulings paragraph 104.9.4 under an identical heading. Those statements concluded that if a registered person accounting for GST on an invoice basis subsequently sold a debt for less than its face value, the Commissioner would allow the registered person a bad debt deduction under s 26 for the difference between the debt's face value and the sale proceeds. The inference being that the difference between the two amounts was a bad debt.
9. At that time, a person accounting for GST on an invoice basis was required to return GST on the full amount from the sale of goods or services at the time of supply, whereas a person accounting for GST on a payments basis was only required to return GST on the discounted amount received on the sale of the debt. The policy set out in PIB No 164 and Technical Rulings paragraph 104.9.4 addressed the mismatch of GST treatments between the two accounting bases under the GSTA.
10. Barber DJ in *Case T27* (1997) 18 NZTC 8,188, however, reached a different conclusion from that set out in PIB No 164 and Technical Rulings paragraph 104.9.4. In particular, the Taxation Review Authority concluded that if a registered person factors a debt owing for less than its face value, the difference between the face value of the debt and the amount received from the Factor is not a bad debt.
11. Consequently, Public Ruling "BR Pub 00/07: Debt factoring arrangements and GST" (BR Pub 00/07) was published in 2000, which confirmed that the Commissioner accepted the view of Barber DJ in *Case T27*. The Ruling changed and superseded the earlier policy set out in PIB No 164 and Technical Rulings paragraph 104.9.4.
12. Further, section 26A was enacted in 2000 to require a person accounting for GST on a payments basis to return GST on the remaining book value of a debt when it is factored. Section 26A, therefore, establishes parity between the two GST accounting bases.

13. It is the Commissioner's view that if a registered person factors a debt owing for less than its face value, the difference between the face value of the debt and the amount received from the Factor is not a bad debt. Accordingly, s 26 has no application, and a registered person cannot claim a deduction from output tax under s 20(3)(i).
14. BR Pub 00/07 was replaced by "BR Pub 06/01: Debt factoring arrangements" (BR Pub 06/01) and GST in 2006 after BR Pub 00/07 expired. Both Public Rulings are essentially the same. This Ruling replaces BR Pub 06/01.

Application of the legislation

15. This part of the commentary will briefly discuss the GST consequences for an Assignor when a debt is factored. It will then set out the reasons why the price difference between the face value of the debt and the price received from the Factor is not a bad debt amount.

GST consequences when a debt is factored

16. When a debt is factored for less than its face value, there are differences in the way the GSTA operates for an Assignor, depending on whether the Assignor accounts for GST on an invoice basis or a payments basis. Despite these differences, the outcome since the enactment of s 26A is the same for both accounting bases ie, the Assignor is required to pay output tax on the face value of the debt and cannot claim an input tax deduction for a bad debt write off simply by accepting a lesser value by factoring the debt.

Invoice basis

17. A person registered to account for GST on an invoice basis is liable for output tax on the supply of goods or services at the time an invoice is issued.
18. The subsequent factoring of the debt from the Assignor to the Factor would be considered a financial service under s 3(1)(c), being a transfer of ownership of a debt security. It is, therefore, an exempt supply under s 14(1).
19. Consequently, for an Assignor accounting for GST on an invoice basis, no GST liability is incurred at the time the debt is factored.

Payments basis

20. A registered person accounting for GST on a payments basis, who has not received a payment for the supply of goods or services, is not liable for GST output tax at the time the goods or services was originally supplied.
21. The subsequent factoring of the debt for less than its face value would not be considered a supply of "financial services" under s 3(1) because of s 3(4)(a). Section 3(4)(a) applies where, as a result of the transfer of a debt, no output tax for the supply would be attributable to a taxable period. This means an Assignor accounting for GST on a payments basis would be required to return GST on the amount received from the sale because s 3(4)(a) makes that transaction a taxable supply when it would otherwise have been a financial service.
22. Furthermore, s 26A specifically requires a person registered to account for GST on a payments basis to return GST on the remaining book value of the debt when the debt is factored.
23. Therefore, by virtue of ss 3(4)(a) and 26A, the full face value of the debt is considered a taxable supply and an Assignor accounting for GST on a payments basis is liable for GST on the full amount of the debt at the time the debt is factored.

Bad debt deduction

24. Under s 26, a registered person can make a deduction under s 20(3)(i) if that person has:
    - made a taxable supply for consideration; and
    - furnished a return in relation to the taxable period during which the output tax on the supply was attributable and has properly accounted for the output tax on that supply as required under GSTA; and
    - written off as a bad debt the whole or part of the consideration not paid to that person.
25. The amount that may be deducted is the same amount of GST charged as the amount written off bears to the total consideration for the supply. If the supply is the supply of goods under a hire purchase agreement, the proviso to s 26 limits the deduction to the portion of the amount written off as the cash price bears to the total amount payable under the hire purchase agreement.

26. Section 26(1AB) specifies that a registered person accounting for GST on a payments basis can apply s 26 to the supplies to which s 9(2)(b) (door to door sales), s 9(3)(b) (hire purchase agreements), or s 26A (accounting for GST on the remaining book value of a factored debt) applies.
27. If a registered person factors a debt owing for less than its face value, the issue arises whether the difference between the face value of the debt and the amount received from the Factor can be an amount "written off as a bad debt".
28. The term "bad debt" is not defined in the GSTA. Whether the debt is written off as "bad", according to the requirements in s 26(1), depends on the application of the tests outlined in BR Pub 18/07:
29. BR Pub 18/07 confirms that a debt (or part of a debt) is a bad debt where:
    - an existing debt is owing to the taxpayer; and
    - the debt is adjudged as "bad" by a reasonably prudent commercial person who concluded that there is no reasonable likelihood that the debt will be paid in whole or in part by the debtor or by anyone else; and
    - the bad debt is "written off" in accordance with the accounting and record keeping systems maintained by the taxpayer.

The debt must exist

30. Cases indicate that before a debt can be written off, a debt must be in existence at the time the debt is written off (*Budget Rent A Car Ltd v CIR* (1995) 17 NZTC 12,263 and *GE Crane Sales Pty Ltd v FC* of T 71 ATC 4268). Accordingly, for s 26 to apply, the registered person must be able to show that at the time of writing off the debt, a debt was then in existence.
31. In terms of non-recourse debt factoring, at the time the debt is sold, the debt between the registered person and debtor is extinguished and replaced with a separate and distinct debt between the Factor and debtor. In such situations no debt exists at the time the amount is written off, which will be after sale of the debt. Therefore, after the sale of the debt to the Factor, no further debt exists and according to both *Budget Rent A Car Ltd and G E Crane Sales Pty Ltd* no amount can be written off as a bad debt.
32. In terms of recourse debt factoring arrangements when a debt is sold by the Assignor on a recourse basis, the title to the debt passes to the Factor unless the Factor exercises a recourse option or right by which the debt can be transferred back to the Assignor. Therefore, until the recourse is exercised and the debt is transferred back, a bad debt deduction is not available under s 26(1), as after the sale there is no debt owed to the Assignor.
33. However, if the Factor exercises an option or right to transfer some portion of the debt back to the Assignor after the sale then, once this has occurred, a debt exists that is owed to the Assignor that may be able to be written off by the Assignor. Under s 26(1AA), s 26(1) applies if a registered person sells a debt and then reacquires it. Whether it can be written off depends on the application of the tests for determining whether a debt is bad in BR Pub 18/07.

The debt must be "bad"

34. When assessing whether a bad debt exists, BR Pub 18/07 indicates that a debt is bad when a reasonably prudent commercial person would have concluded, based on the information available about the debtor's ability to repay the debt, that there is no reasonable likelihood that the debt will be paid. In the absence of such a circumstance, if a registered person chooses to sell a debt for below its face value, no bad debt exists and no deduction is available under s 20(3)(i).

The debt must be "written off"

35. BR Pub 18/07 establishes that, to write-off a debt as bad under s 26(1), reasonable steps must be taken to determine whether that particular debt owed by that particular debtor is likely to be paid (*Case P53* (1992) 14 NZTC 4370 and *Budget Rent A Car v C of IR* (1995) 17 NZTC 12263).
36. Writing-off a portion of debt on this basis involves seeking a deduction for the provision for doubtful debts. As noted in BR Pub 18/07, the GSTA does not allow a deduction for the provision for doubtful debts.

Writing off the debt before sale to the Factor

37. In the past we have received submissions which noted that the issue of whether the discount to the Factor might be written off as a bad debt under s 26(1) would not arise if this amount were written off prior to the sale of the debt to the Factor.
38. The Commissioner agrees that this is the case. If a portion of a debt is written off before it is sold to the Factor, then whether the debt is written off as bad according to the requirements in s 26(1) depends on the application of the tests outlined in Public Ruling BR Pub 18/07.

39. This could happen where the registered person sells its bad debts to a Factor whose core business is to purchase bad debts in bulk from various vendors for a small fraction of the bad debts' face value. This is beneficial to both the Assignor, who is able to recover some money for the debt, and the Factor, who has the advantage of economies of scale to recover the debts that would otherwise be irrecoverable.
40. In these circumstances, the sale of the debt to the Factor will give rise to a full or partial recovery of the amount written off, and output tax will be payable by the Assignor on the portion of the debt recovered in the period when the amount is recovered under s 26(2).

Conclusion

41. In conclusion, the Commissioner considers that the difference between the face value of the debt and the amount received from the Factor cannot be an amount written off as a bad debt under s 26. Rather than being a bad debt, the discount from face value is simply a result of the process of agreeing the consideration for the debt that is acceptable to both the Assignor and the Factor. The reasons for this view are:
    - Cases considering the meaning of bad debt focus on whether the creditor can recover the outstanding amounts owing. That is, a bad debt arises when the creditor is unable or unlikely to recover the debt owing. If the creditor could recover the full amount owing but chooses not to (as in a debt factoring situation), any "loss" suffered by the creditor is not due to a bad debt.
    - Cases also indicate that for an amount to be written off as a bad debt, a debt must exist at the time the debt is written off. If a registered person factors a debt, no further debt exists between the registered person and debtor, and no amount can be written off as a bad debt. However, if a debt has been sold and then reacquired, an input tax deduction may be available if the tests in BR Pub 18/07 are subsequently met.

Examples

42. The following example illustrates the consequence of this ruling.

Example 1 – Invoice basis

VendorIn Co sells the debts relating to the sale of the widgets to Factor Co for $80. The sale of the debts to Factor Co is considered a "financial service" under s 3(1)(c) and it is, therefore, an exempt supply under s 14(1).

At the time VendorIn Co sells the debts to Factor Co those debts were not "bad". As such Vendor Co is not entitled to an input tax deduction under ss 26 and 20(3)(i).

Example 2 – Payments basis

VendorPay Co accounts for GST on a payments basis. It sells 100 widgets to its customers for $100 on a buy now, pay later basis. VendorPay Co has no output tax on the sale of the 100 widgets because it has not received a payment for the sale.

VendorPay Co sells the debts relating to the sale of the widgets to Factor Co for $80. The sale of the debts to Factor Co is excluded from being a "financial service" under s 3(4)(a). Therefore, VendorPay Co is required to pay output tax on the $80 received from Factor Co. Further, s 26A requires VendorPay Co to account for output tax on the remaining book value of the debt of $20. Consequently, VendorPay Co is required to pay output tax on the full value of the debt of $100 at the time it sells its debts to Factor Co.

At the time VendorPay Co sells the debts to Factor Co those debts were not "bad". As such VendorPay Co is not entitled to an input tax deduction under ss 26 and 20(3)(i).

Legislation

43. The relevant provisions in the Goods and Services Tax Act 1985 are as follows:

3 Meaning of term financial services

(1) For the purposes of this Act, the term **financial services** means any 1 or more of the following activities:

…

(c) the issue, allotment, drawing, acceptance, endorsement, or transfer of ownership of a debt security:

…

(4) Despite this section, **financial services** does not include—

(a) the assignment or other transfer of a right to receive payment in relation to a taxable supply if, as a result of the assignment or transfer, output tax for the supply would not be or become attributable to a taxable period for the purpose of section 20(4):

…

14 Exempt supplies

(1) The following supplies of goods and services shall be exempt from tax:

(a) the supply of any financial services (together with the supply of any other goods and services, supplied by the supplier of those financial services, which are reasonably incidental and necessary to that supply of financial services), not being a supply referred to in subsection (1B):

…

20 Calculation of tax payable

(2) In respect of each taxable period every registered person shall calculate the amount of tax payable by that registered person in accordance with the provisions of this section.

…

(3) Subject to this section, in calculating the amount of tax payable in respect of each taxable period, there shall be deducted from the amount of output tax of a registered person attributable to the taxable period—

…

(i) any amount calculated in accordance with section 26; ...

…

26 Bad debts

(1) Where a registered person—

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

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

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

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

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

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

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

…

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

…

26A Factored debts

(1) This section applies to a registered person who—

(a) sells a debt to another person during a taxable period; and

(b) is required to account for tax payable on a payments basis.

(2) The sale of the debt is treated as being a taxable supply—

(a) That is made by the registered person during the taxable period; and

(b) on which the amount of tax charged is the tax fraction of the remaining book value of the debt.

References

Expired Rulings

Public Ruling "BR Pub 00/07: Debt factoring arrangements and GST" *Tax Information Bulletin* Vol 12, No 8 (August 2000)

Public Ruling "BR Pub 06/01: Debt factoring arrangements and GST" *Tax Information Bulletin* Vol 18, No 5 (June 2006)

Related Rulings

Public Ruling "BR Pub 18/07: Income Tax and Goods and Services Tax – writing off debts as bad" *Tax Information Bulletin* Vol 30, No 9 (October 2018)

Case References

Case T27 (1997) 18 NZTC 8,188

Legislative References

Goods and Services Tax Act 1985 – ss 3(1), 3(4), 14(1), 20(3)(i), 26 and 26A

Notice of Withdrawal of Public Ruling BR PUB 06/01

1. This is a notice of withdrawal of a public ruling made under section 91DE of the Tax Administration Act 1994.
2. Public Ruling BR Pub 06/01 – Debt factoring arrangements and GST applies from 1 August 2005 for an indefinite period.
3. Public Ruling BR Pub 06/01 is withdrawn on 9 August 2021.

BR Pub 06/01 is being withdrawn because it contains an incorrect section reference. Further, BR Pub 06/01 only applies to persons who account for GST on an invoice basis, due to inconsistencies in the law between invoice and payments basis when the public ruling was originally issued. Changes in the law have meant that these inconsistencies no longer exist so it is possible to issue a ruling to cover both invoice and payments basis persons. BR Pub 06/01 applies up to, and including, 9 August 2021.

A new replacement public ruling, BR Pub 21/03 – Debt factoring arrangements and GST is being published with effect from 10 August 2021. In addition to correcting the section reference, the ruling has been updated so that it applies to persons accounting for GST on both invoice and payments basis.

This notice is signed on 17 June 2021.

Susan Price

Group Leader – Public Advice and Guidance

Tax Counsel Office

OPERATIONAL STATEMENT

Operational statements set out the Commissioner of Inland Revenue's view of the law in respect of the matter discussed and deal with practical issues arising out of the administration of the Inland Revenue Acts.

OS 21/02: Administration of the imported mismatch rule – section FH 11

Introduction

1. The imported mismatch rule in s FH 11 is one of the hybrid mismatch rules introduced as subpart FH with effect for income years beginning on and after 1 July 2018. Section FH 11 is discussed in detail in *Tax Information Bulletin* Vol. 31, No. 3 (April 2019) from page 74.
2. The purpose of the imported mismatch rule is to deny a deduction for a payment by a New Zealand taxpayer to the extent that that payment funds, directly or indirectly, a hybrid mismatch occurring entirely outside New Zealand, if certain requirements are met. This Statement sets out the Commissioner's approach to administering the imported mismatch rule.
3. This Statement is not intended to provide a safe harbour. Compliance with the Statement does not guarantee that there will be no deductions disallowed under s FH 11. However, compliance with the Statement will reduce the likelihood of lack of reasonable care penalties being imposed where an imported mismatch is later found to exist.

Summary of approach

4. Where a taxpayer makes a deductible payment to a person who is resident in a country that does not have hybrid mismatch rules corresponding to those in subpart FH, they are expected to take certain steps in order to ensure compliance with the imported mismatch rule contained in the section.
5. This Statement deals with payments that are made to a person who is in the same group as the taxpayer. Where the steps required by the Commissioner, as explained in [13] are taken a taxpayer will have complied with their self-assessment obligations under s FH 11.
6. Where the appropriate steps are not taken the Commissioner may require evidence of the taxpayer's compliance with s FH 11. Where evidence is not provided in a timely manner, this may result in a denial of the relevant deductions in New Zealand, and in the taxpayer being unable to present such evidence subsequently in a dispute.

Application of the statement

7. This Operational Statement applies to all arrangements referred to in s FH 11 and applies from the 2021 income year.

Discussion

Criteria

8. The criteria for the application of s FH 11 are as follows:
    1. A New Zealand resident taxpayer or a New Zealand deducting branch (funder) makes a payment in an income year,
    2. To a person in a country outside New Zealand that is not subject to hybrid rules equivalent to those in New Zealand in relation to that payment,
    3. The funder is allowed a deduction in New Zealand for the payment,
    4. The payment provides funds, directly or indirectly, for a payment (funded payment) by a person outside New Zealand (payer) to another person (payee), and
    5. The funded payment gives rise to a hybrid mismatch that is not counteracted by hybrid mismatch rules.

9. The imported mismatch rule applies to payments to third parties (but only if there is a structured arrangement) and payments to control group members (whether or not the arrangement is a structured arrangement). The rule applies to structured arrangements in income years commencing on or after 1 July 2018 and non-structured arrangements in income years commencing on or after 1 January 2020.
10. Compliance with the imported mismatch rule requires New Zealand resident taxpayers and New Zealand deducting branches to have knowledge of the tax treatment of payments that are made entirely outside of New Zealand. This requires them to obtain information from persons outside New Zealand.
11. The following is an outline of the approach that the Commissioner expects taxpayers to take to ensure they are complying with the imported mismatch rule in relation to payments to control group members. If this approach is not taken, taxpayers risk having deductions denied.

Determining whether adjustments required

12. In accordance with s FH 11, if a New Zealand taxpayer funds a hybrid mismatch that occurs outside New Zealand an adjustment denying a deduction for some or all of the payments made by the New Zealand taxpayer is required to reflect the amount of the hybrid mismatch that has been funded by the payment from New Zealand. This will require the New Zealand taxpayer to have access to information relating to the offshore tax treatment of payments made outside New Zealand. Particularly in the case of a group whose headquarters are outside New Zealand, New Zealand's tax reporting will be relying on people outside of New Zealand being able to provide information on whether or not hybrid mismatches exist. These hybrid mismatches can occur, directly or indirectly, as part of structured transactions or unstructured transactions within control groups.
13. To comply with their self-assessment obligations under s FH 11 in respect of payments to control group members, the Commissioner expects that New Zealand taxpayers will:
    1. Identify payments made to non-resident control group members that are tax deductible before applying the imported mismatch rule,
    2. Determine whether any such payments are to a person that is in a jurisdiction that has not implemented hybrid mismatch rules equivalent to New Zealand's, and
    3. If the answer to 2 is yes, before claiming a deduction ensure that the group head office tax function has undertaken appropriate work to:
    - identify any hybrid mismatches within the group; and
    - determine the extent to which these are funded by otherwise deductible payments from New Zealand payers.
14. If the taxpayer is part of a group headquartered in:
    - New Zealand, the work referred to in step 3 will generally be taken by group employees in New Zealand, or at their direction
    - another country, the work referred to in step 3 may well be undertaken by group employees outside New Zealand. In that case, the Commissioner expects that the taxpayer will obtain from the group's head office tax function a written statement regarding that work.
15. For tax years beginning before 1 January 2020, in which only the structured imported mismatch applies, enquiries by the group head office tax function may be limited to those necessary to determine whether there is or are, in relation to all transactions that are part of a structured arrangement involving the otherwise deductible payment by the New Zealand taxpayer, pricing or other facts or circumstances which mean that a member of the control group could reasonably be aware of the existence of the hybrid mismatch. For later tax years, this limitation does not apply.
16. In the case of a group that is not headquartered in New Zealand, if the steps taken by the group's head office tax function and communicated to the New Zealand taxpayer can reasonably be expected to accurately determine the extent, if any, of the application of the imported hybrid mismatch rule, and the taxpayer has no reason to believe that the determination is not correct, then the taxpayer has complied with its self-assessment obligations with respect to the rule.

17. There is no prescribed form for such a statement, but an example is provided below of the type of statement the Commissioner would expect to be provided, addressed from the Group Head of Tax to the relevant New Zealand personnel:

    "I have ensured that suitably qualified personnel within the group have reviewed the tax treatment of all deductible cross-border payments by members of the group to determine whether they give rise to a hybrid mismatch. As a result of this review I can advise that

    [if no hybrid mismatches funded by New Zealand] [New Zealand subsidiary/deducting branch] payments have not funded directly or indirectly any such mismatches;

    [Or, if there are hybrid mismatches funded by New Zealand] [New Zealand subsidiary/deducting branch] payments totalling $[.] have funded directly or indirectly such mismatches;

    In undertaking this review and making this determination, the principles set out in the OECD Final Report on hybrid mismatches and/or section FH 11 of the New Zealand Income Tax Act 2007 have been considered and complied with."

No Evidence Obtained

18. Where a New Zealand taxpayer has:
    - Claimed a deduction for payments to non-resident control group members in countries without hybrid rules corresponding to subpart FH, and
    - In the case of a taxpayer that is a member of a foreign headquartered group, received no statement from its group head office tax function as set out above,
    - In the case of a taxpayer that is a member of a New Zealand headquartered group, does not have evidence that the possible application of section FH 11 has been appropriately considered and analysed.

    then the Commissioner may request from the New Zealand taxpayer, under s 17B of the Tax Administration Act (TAA), such a statement, or other evidence that the imported hybrid mismatch rule has been considered.

19. If a satisfactory response is not provided within 3 months the Commissioner may apply s 17F of the TAA to deny relevant deductions claimed in New Zealand, and, if proper notice is given, apply the evidence exclusion rule in s 17F(3) of the TAA.

This Statement was signed on 30 June 2021.

Rob Falk

National Advisor, Technical Standards, Legal Services

Legislative references

Income Tax Act 2007

Section FH 11

Section FH 15

Tax Administration Act 1994

Section 17B

Section 17F

INTERPRETATION STATEMENT

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 21/05: Non-cash dividends

Introduction

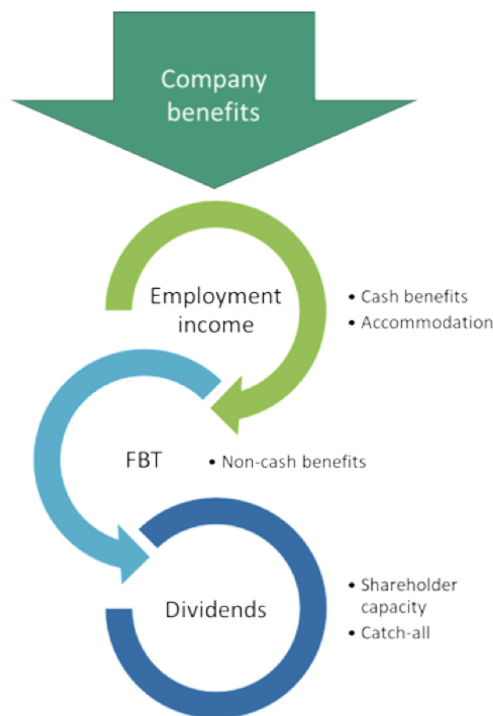
1. This Interpretation Statement considers when a non-cash transfer of company value from a company to a shareholder is treated as a dividend for tax purposes (often referred to as a deemed dividend). It focuses on the types of transactions that are entered into between small and medium-sized companies and their shareholders.
2. The Interpretation Statement first discusses the general rules for determining when a non-cash dividend will arise and provides some simple examples to assist readers to understand the concepts. It then summarises the more complex rules for calculating the amount of a dividend in different situations, also with examples.
3. This Interpretation Statement is intended to raise awareness of when simple non-cash transactions will give rise to dividends. It does not consider the more complex rules relating to share repurchases, statutory producer boards, co-operative companies, foreign unit trusts, superannuation schemes, share-lending arrangements or emigrating companies. It also does not consider the rules relating to dividends arising within groups of companies.
4. In addition, the payment of a cash or non-cash dividend gives rise to a number of administrative obligations, including disclosures, requirements to provide dividend statements and withholding tax obligations. These obligations are not discussed in this Interpretation Statement. However, taxpayers should be aware that these obligations exist and seek further advice on how to comply with them.

Interaction with other rules

5. Non-cash transfers of value from a company to a person can arise for a number of reasons. In particular, a company may transfer value to a person because:
    - they are, or are associated with, an employee of the company, as compensation for the employee's services; or
    - they are, or are associated with, a shareholder of the company.

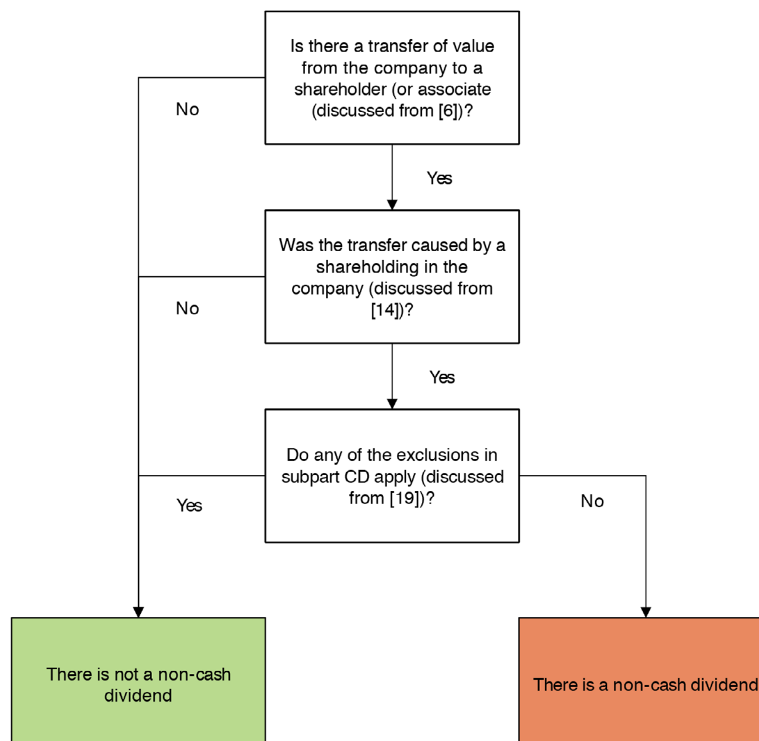
    In the case of small and medium sized enterprises it is often the case that people involved in the company are both employees and shareholders.
6. Because transfers of value can be caused for various reasons, the first question to ask in determining the tax treatment of the transfer is – what is the reason for the transfer?
7. Where the transfer of value is caused by an employment relationship, the transfer will usually be taxed either as employment income, or as a fringe benefit. Employment income is usually paid in cash but can also include some non-cash benefits, including the provision of accommodation. This is discussed in more detail from [50]. A fringe benefit is a non-cash benefit an employer provides to an employee in connection with their employment. This is discussed in more detail from [54].
8. Where a transfer of value is caused by an employment relationship it will, usually, not be a dividend. However, in some cases where the non-cash benefit is provided to an employee who is also a shareholder, the fringe benefit rules either require that the benefit be treated as a dividend and not as a fringe benefit, or allow the company to choose whether to treat the benefit as a fringe benefit or a dividend. These situations are discussed at [57].
9. Where the transfer of value is not caused by an employment relationship, or the fringe benefit rules allow the company to choose, or require the company to treat the transfer as a dividend, the dividend rules become relevant. These situations are the focus of this Interpretation Statement.

10. This process of determining which tax rules apply to a transfer of value is illustrated by the following graphic:



Amounts that are a dividend

11. Subpart CD describes what is and is not a dividend. Under s CD 4, a dividend is a transfer of company value from a company to a person, if:
    - the cause of the transfer is a shareholding in the company; and
    - none of the exclusions in subpart CD apply.
12. This statement focuses on the provision of non-cash dividends.
13. The following flow-chart illustrates how to determine whether a non-cash dividend has been paid:



Transfers of company value

14. Section CD 5 defines a "transfer of company value" for the purpose of the dividend rules in subpart CD. Under s CD 5(1) a transfer of company value from a company to a person will occur when:
    - the company provides money or money's worth to the person; and
    - if the person provides money or money's worth to the company in exchange, the market value of what the company provides is more than the market value of what the person provides.
15. Case law indicates that the expression "money or money's worth" requires that a benefit be in money or be convertible into money, either directly or indirectly (*Tennant v Smith* (1892) 3 TC 158 (HL), *Stagg v CIR* [1959] NZLR 1,252 (HC), *Abbott v Philbin (Inspector of Taxes)* [1960] 2 All ER 763 (HL), *Heaton (Inspector of Taxes) v Bell* [1969] 2 All ER 70 (HL) and *Dawson v CIR* (1978) 3 NZTC 61,252 (SC)). A benefit will be directly convertible into money where the benefit can be exchanged for a monetary equivalent (*Dawson* at 61,257). For example, shares that are capable of being sold for money will be money's worth. Non-cash dividends are transfers of money's worth from a company to a shareholder.
16. The remainder of s CD 5 clarifies whether money's worth arises in four situations.
17. First, money's worth **is** provided by a company to a person where the person is released from repaying a debt to the company, either by agreement or by operation of law (unless the company and the person are part of the same wholly-owned group) (s CD 5(2)). This means a dividend may arise if a company releases a shareholder from repaying a debt.
18. Secondly, money's worth **is not** provided by a person to a company on the cancellation of a share the person holds or the cancellation of the person's rights as a shareholder (s CD 5(2B)). This section means that in cases where a transfer of money or money's worth from the company to a shareholder occurs on the cancellation of a share, the shareholder is deemed to provide nothing in return. This may be a dividend.
19. Thirdly, money's worth **is not** provided by a company to a person where the company provides services to the person (s CD 5(3)). This means a dividend will not arise simply because a company provides services that it ordinarily provides as part of its business to a shareholder for less than market consideration. "Services" are anything that is not goods, money or a chose in action (a chose in action includes the right to use property).
20. And fourthly, money's worth **is** provided by a company to a person if the company is a close company and the company provides services consisting of the benefit of expenditure by the company to the person (s CD 5(4)). This means, where a company is a close company and the company incurs expenditure on behalf of a shareholder, a dividend may arise. A close company is generally a company with five or fewer natural persons or trustees whose total voting interest in the company is more than 50% (treating all natural persons associated at the time as one person).
21. Example 1 to Example 5 illustrate when a transfer of company value occurs under the provisions discussed above. The examples show when a transfer of company value occurs. How the transfer of company value is taxed (for example, whether as a dividend or under the fringe benefit tax (FBT) regime) is considered below.

Example 1 – Simple transfer of company value

Hannah is a shareholder in Hannah's Bananas Ltd. In the 2020 income year, Hannah's Bananas Ltd provides Hannah with a lot of fresh bananas.

Hannah's Bananas Ltd has provided money's worth to Hannah. Hannah has not provided any money or money's worth to Hannah's Bananas Ltd. Therefore, there is a transfer of company value from Hannah's Bananas Ltd to Hannah.

Example 2 – Release from repayment of a debt

Ike is a shareholder in Ike's Bikes Ltd. Ike's current account is overdrawn by $100. In the 2021 income year, Ike's Bikes Ltd agrees to release Ike from having to repay the current account debt.

By releasing Ike from the obligation to repay the current account debt, Ike's Bikes Ltd has provided money's worth to Ike under s CD 5(2). Ike has not provided any money or money's worth to Ike's Bikes Ltd. Therefore, there is a transfer of company value from Ike's Bikes Ltd to Ike.

Example 3 – Cancellation of shares

Fiona is a shareholder in Fiona's Feijoas Ltd. Fiona's Feijoas Ltd buys back Fiona's shares for $100.

In buying back Fiona's shares, Fiona's Feijoas Ltd has transferred value to Fiona. Under s CD 5(2B), Fiona has not transferred any value to Fiona's Feijoas Ltd by giving up her interest in the shares. Therefore, Fiona's Feijoas Ltd has transferred value to Fiona.

Note: This example does not consider whether the share repurchase will give rise to a dividend. The rules for determining whether a share repurchase will result in a dividend are in ss CD 22 to CD 25. Generally, an amount will not be a dividend to the extent to which it is equal to or less than the available subscribed capital per share, provided various bright-line tests are met and the payment is not in lieu of a dividend.

Example 4 – Provision of services

Cam is a shareholder in Cam's Coms Ltd, which is a widely held company. Cam's Coms Ltd provides telecommunication services. Cam's Coms Ltd provides Cam its telecommunication services for free.

Under s CD 5(3), the provision of the telecommunication services by Cam's Coms Ltd to Cam is not money's worth. Therefore, the provision of these services at an undervalue will not give rise to a transfer of company value.

Example 5 – Provision of services in a close company

Mel is a shareholder in Mel's Mowing Ltd. Mel's Mowing Ltd is a close company. Mel's Mowing Ltd pays for Mel's personal car to be cleaned at a cost of $50.

By incurring expenditure that gives rise to a benefit to Mel, Mel's Mowing Ltd has provided money's worth to Mel under s CD 5(4). Therefore, the expenditure on cleaning Mel's personal car gives rise to a transfer of company value from Mel's Mowing Ltd to Mel.

Caused by a shareholding

22. Under s CD 6, a transfer of company value will be caused by a shareholding where:
    - the recipient is a shareholder in the company or is associated with a shareholder in the company; and
    - the company makes the transfer because of that shareholding.
23. One indication that a transfer is caused by a shareholding is if the terms of the arrangement that results in the transfer are different from the terms on which the company would enter into a similar arrangement if no shareholding were involved (s CD 6(2), *Case V9* (2001) 20 NZTC, 10,101 (TRA) and *Campbell v CIR* [1968] NZLR 1 (HC)).
24. As discussed above, if the transfer of value is caused by an employment relationship and is not caused by the person's shareholding in the company, then it will not be a dividend. Instead, the benefit will be subject to the employment income or fringe benefit rules. Where a person is both a shareholder and an employee, one indication that the transfer of value is **not** caused by the shareholding may be that the person is the only shareholder who received a transfer of value.
25. The following examples explain when a dividend will be caused by a shareholding.

Example 6 – Dividend caused by a shareholding – distribution of goods

Grant is a shareholder in Grant's Plants Ltd. He is not an employee. During the 2020 income year, Grant acquires an inner-city apartment and as part of furnishing it, uses an extensive selection of plants from Grant's Plants Ltd.

The distribution of plants is a transfer of company value from Grant's Plants Ltd to Grant. Grant's Plants Ltd would not have given its plants to Grant if Grant was not a shareholder in the company. Therefore, the transfer of company value is caused by the shareholding.

Example 7 – Dividend caused by a shareholding – private use of assets

Pat is a shareholder in Pat's Pears Ltd. Pat's Pears Ltd allows Pat to use one of its vehicles for his private purposes (Pat is not an employee of Pat's Pears Limited). Pat does not make any payment to Pat's Pears Ltd in exchange for the use of the vehicle.

Pat's Pears Ltd has transferred value to Pat by allowing him to use one of its vehicles without requiring any payment in exchange. Pat's Pears Ltd would not allow a person unconnected with the company to use its vehicles. Pat's only connection with the company is his shareholding. Therefore, the transfer of company value is caused by the shareholding.

Example 8 – Dividend not caused by a shareholding

Linda is a shareholder in Linda's Lamingtons Ltd. She is not an employee. Linda's Lamingtons Ltd has a sale and sells its products at a discounted price. Linda purchases some discounted products in the sale.

Linda's Lamingtons Ltd has provided money's worth to Linda because it has sold Linda goods at an undervalue. However, the transfer of value is not caused by the shareholding. This is because the same discounts are offered to all of Linda's Lamingtons Ltd's customers.

Example 9 – Dividend paid to an associate

Angel's Family Trust owns all the shares in Angel's Antiques Ltd. Angel is a settlor, trustee and beneficiary of Angel's Family Trust. Angel is not an employee of Angel's Antiques Ltd. Angel's Antiques Ltd gives Angel a valuable antique from its store.

The gift of the valuable antique is a transfer of company value from Angel's Antiques Ltd to Angel. While Angel is not a shareholder of Angel's Antiques Ltd, she is associated with the sole shareholder, Angel's Family Trust. Angel's Antiques Ltd would not have given Angel the antique if she was not associated with a shareholder. Therefore, the transfer of company value is caused by a shareholding.

Specific transactions that are treated as dividends

26. As well as defining a dividend in general terms, subpart CD also specifies types of transactions that will give rise to dividends:
    - **Making a bonus issue in lieu** (s CD 7) – being an arrangement where shareholders of a company are given an election as to whether to receive a bonus issue of shares for no consideration, or money or other money's worth.
    - **Issuing a share under a profit distribution plan** (s CD 7B) – being a scheme where a company notifies shareholders that shares are to be issued and gives the shareholders an option to have some or all of the shares repurchased by the company (other than the issue of shares under an employee share scheme or a share repurchase scheme).
    - **Making a taxable bonus issue** (s CD 8) – being a bonus issue fully paid from reserves that the company chooses to treat as a dividend.
    - **Dividends arising under specific avoidance provisions** (s CD 11) – being:
      - Where shares are disposed of in substitution for a dividend (that is, dividend stripping arrangements) (s GB 1);
      - Where the company employs a relative of a director or shareholder to provide services, and the Commissioner considers the income payable to the relative is excessive (s GB 23); or
      - Where a close company provides remuneration for services to a shareholder, director, or relative of a shareholder or director who is not an adult employed substantially full-time in the business who participates in the management or administration of the company, and the Commissioner considers the remuneration is excessive (s GB 25).

      Sections GB 23 and GB 25 concerning excessive payments are considered in "QB 14/09: Income tax – meaning of 'excessive remuneration' and 'excessive profits or losses' paid or allocated to relatives, partners, shareholders or directors", *Tax Information Bulletin* Vol 26, No 9 (1 October 2014): 22.
    - **Providing non-cash benefits to shareholders (s CD 20)** – being:
      - unclassified benefits provided to employee shareholders that the company chooses to treat as a dividend; and
      - non-cash benefits provided to a non–executive director who is a shareholder of the company.

    The treatment of non-cash benefits that are fringe benefits is discussed from [54].

Specific transactions that are not treated as dividends

27. The final requirement in determining whether an amount is a dividend is to determine whether the amount is specifically excluded from being a dividend under ss CD 22 to CD 37.
28. This Interpretation Statement does not consider all of the situations in which an amount will not be a dividend. However, in the context of the scenarios covered by this item, the most common exclusion that will apply is the exclusion for a transfer of value that is treated as a fringe benefit (s CD 32), which is discussed further from [54].
29. Subpart CD also confirms that transactions that will not give rise to dividends include:
    - non-taxable bonus issues (s CD 29); and
    - a flat-owning company making residential property available to a person (s CD 31).

30. For completeness, other transactions that also do not give rise to dividends are:
    - share repurchases (ss CD 22 to CD 25).
    - capital distributions on liquidation or emigration (ss CD 26); and
    - transactions within a group of companies (ss CD 27 and CD 28).
31. Further consideration of these provisions is outside the scope of this Interpretation Statement.

Calculating the amount of a dividend

General rule

32. Under s CD 38, the amount of a dividend is calculated using the formula:

    value from company – value from person

33. The "value from the company" is the market value of the money or money's worth that the company provides to the person. The "value from the person" is the market value of the money or money's worth, if any, that the person provides to the company in exchange. This excludes any amount attributable to holding or giving up rights as a shareholder in the company. This is shown in Example 10.

Example 10 – Value of the dividend

Jon is a shareholder in Jon's Scones Ltd. Jon's Scones Ltd has recently replaced one of its ovens. Jon thinks the old oven would be useful in his refurbished farmhouse. Jon takes the oven for his own personal purposes. Jon gives Jon's Scones Ltd $50 for the second-hand oven when its market value is $500.

Jon's Scones Ltd has provided value of $500. Jon has provided value of $50. Therefore, the value of the dividend is $450 (being $500 less $50).

34. Generally, a dividend will be treated as having been paid on the date the transfer of value arises.

Making property available

35. Specific rules also apply to calculate the amount of a dividend where a company makes property available to a person (s CD 39). A company makes property available to a shareholder when the company allows the shareholder to use property that the company owns for the shareholder's private purposes. As noted at [19], the right to use property is a chose in action and, therefore, is not a "service" as defined. It could be argued that a company provides a "service" to a shareholder by allowing them to use its property, which is excluded from being a transfer of value under s CD 5(3). However, the Commissioner considers the better view is that, by allowing a shareholder to use property that the company owns, the company is providing the shareholder with a right to use property, which is a chose and action, and not a service. This view is more consistent with the fact that the Act includes rules for calculating the amount of a dividend where a shareholder uses a company's property.
36. Under these rules, the amount of the dividend is calculated for each quarter during which the property is made available. The dividend is treated as being paid six months after the end of the company's income year, unless the company gives the shareholder earlier notice of the amount of the dividend.
37. Where the property **is not a loan**, the amount of the dividend for each quarter is the value of the fringe benefit that would arise under the fringe benefit rules if the benefit was provided to an employee. Example 11 illustrates this.

Example 11 – Making property available

Cath is a shareholder in Cath's Cabin Ltd. Cath is not an employee of Cath's Cabins Ltd. Cath's Cabin Ltd owns a holiday home that it rents out on Airbnb for $400 per night. Cath uses the holiday home for her own personal benefit for three nights. Cath pays $50 per night.

The amount of the dividend is the value of the fringe benefit that would arise under the fringe benefit rules if the benefit was provided to an employee. Under s RD 41, the value of the fringe benefit is the price ordinarily charged by Cath's Cabin Ltd as part of its business. Under s RD 54, the value of the benefit is reduced by the amount Cath paid. Therefore, the amount of the dividend in this example is $1,050 (being $400 less $50 ($350) per night for three nights).

38. Where the property **is a loan**, the amount of the dividend for each quarter can be calculated in two ways. The amount is either the difference between:
    - the benchmark rate and the actual amount of interest accruing on the loan; or
    - the benchmark rate and the amount of income accruing to the company in the quarter calculated under the yield to maturity method.
39. The "benchmark rate" is the interest calculated for the quarter on the daily balance of the loan calculated as:
    - where all amounts are expressed in New Zealand dollars, and the company notifies the Commissioner when it files its tax return, the prescribed rate of interest declared by regulations; or
    - where all amounts are expressed in a single currency other than New Zealand dollars, and the company notifies the Commissioner when it files its tax return, the benchmark rate the Commissioner set for that currency (if any); or
    - in all other cases, a market rate determined at the end of the quarter for a loan made on the same terms between persons at arm's length.
40. Example 12 shows how a simple dividend is calculated under an interest-free loan.

Example 12 – Interest-free loan

Kiri is a shareholder in Kiri's Construction Ltd. She is not an employee. Kiri borrows NZ$1,000, interest free, from Kiri's Construction Ltd.

Kiri is deemed to have received a dividend equal to the difference between the benchmark rate and the actual amount of interest accruing on the loan. Kiri decides to rely on the prescribed rate of interest declared by regulation rather than determining what a market value for a loan of this type would be. From 1 July 2020, the prescribed interest rate is 4.5%.

For the quarter 1 July 2020 to 30 September 2020, the amount of the non-cash dividend is:

$$\text{Non-cash dividend} = \text{Outstanding loan x interest rate x } \frac{\text{days in quarter}}{365}$$

$$\text{Non-cash dividend} = \$1{,}000 \text{ x } 4.5\% \text{ x } \frac{92}{365}$$

Non-cash dividend = $11.34

41. In calculating the daily balance of the loan, an amount repaid during the tax year is treated as having been applied in repayment of the loan on the later of the start of the company's tax year or the day the loan was made, if:
    - the amount is repaid by applying salary, wages, extra pay, dividends or interest payable by the company to the borrower;
    - the amount payable by the company is income of the borrower in the tax year or an earlier tax year; and
    - the amount payable by the company is payable without any amount of tax being withheld under the PAYE, resident withholding tax or non-resident withholding tax rules, or is a fully imputed dividend.
42. Example 13 shows how the timing rule works for dividends applied in repaying loans.

Example 13 – Repayment of a loan

Michelle is a shareholder in Michelle's Marvellous Muffins Ltd. During the 2020 income year, Michelle borrows NZ$1,000, interest free, from Michelle's Marvellous Muffins Ltd.

In the same year, Michelle's Marvellous Muffins Ltd pays Michelle a fully imputed dividend of $200 (gross dividend of $277.78 including imputation credits of $77.78) that is applied to repay part of the loan. Because the repayment is made in the same year that the loan was provided, Michelle is treated as having made the repayment on the day the loan was originally made, and any dividend arising from the fact the loan was interest-free will reduce accordingly.

Michelle's Marvellous Muffins Ltd pays Michelle another fully imputed dividend of $200 in the 2022 income year that is also applied to repay part of the loan. Because the repayment is made in the income year after the loan was provided, the repayment is treated as being paid at the start of Michelle's Marvellous Muffin's 2022 tax year.

Imputation credits

43. A company may attach imputation credits to a dividend when it is paid (s OB 60). This is the case whether the dividend consists of money or money's worth. However, the requirement that imputation credits be attached when the dividend is paid means an ordinary company cannot attach imputation credits retrospectively if it discovers that a non-cash dividend has arisen unintentionally. In determining when a non-cash dividend is paid it may be necessary to have regard to the calculation rules, which specify when a dividend is treated as having been paid in some situations (discussed above from [32]).
44. The benchmark dividend rules will apply where a company pays more than one dividend during any tax year (including a non-cash dividend). Under those rules the first dividend of the year is the benchmark dividend and the imputation ratio of all dividends paid during the year must match the benchmark dividend (s OB 61). This means that if an unimputed non-cash dividend is the first dividend paid in a tax year, no other dividends paid in that year can be imputed.
45. The benchmark dividend rule also requires that any dividend paid after the benchmark dividend that is not imputed at the same rate as the benchmark dividend (including a non-cash dividend), will result in a debit to the imputation credit account (s OB 61(5)). This will occur despite no imputation credits having been attached to the dividend. The debit is calculated based on the highest amount of imputation credits attached to any distribution during the year, such that it will arise whether the unimputed dividend is paid first, or subsequent to a fully imputed dividend.
46. The benchmark dividend rules can, however, be overridden if the company notifies the Commissioner by providing a ratio change declaration (IR 407) before paying any subsequent dividends, stating that the dividend is not part of an arrangement to obtain a tax advantage under ss GB 35 and GB 36 (s OB 61(6)). This declaration must be witnessed by a Justice of the Peace, solicitor, or other person authorised to take a statutory declaration.

Recovered amounts

47. Calculation rules ensure the treatment of some dividends is reversed if the transaction is reversed. These rules apply where:
    - a company recovers a dividend from a shareholder (s CD 40);
    - a dividend arises because a person was released from an obligation to repay debt, and the debt is later repaid (s CD 41(1));
    - a dividend arises because a close company provided services consisting of the benefit of expenditure by the company to the person and the shareholders believe on reasonable grounds that the expenditure was only for the benefit of the company and the expenditure is later repaid (s CD 41(2));
    - a dividend arises because of a difference between the market value of the property provided by or to the company and the consideration paid for it (s CD 42), and:
        - the consideration paid was an amount the company considered was market value having taken reasonable steps to ascertain the market value; and
        - the recipient of the dividend later paid the company:
    - additional consideration to reflect market value; or
    - a refund of any excess consideration paid by the company.
48. In all cases, the Act ensures the recovered dividend and any imputation credits are disregarded for tax purposes, and a refund of any tax paid occurs. This is shown in Example 14.

Example 14 – Recovered amounts

Taniela is a shareholder in Taniela's Tables Ltd. Taniela is not an employee of Taniela's Tables Ltd. Taniela's Tables pays a dividend to Taniela. However, after the dividend is paid the directors realise that the solvency test has been breached, and they claw back the dividend.

Due to the clawing back of the dividend, the dividend is reversed under s CD 41.

Dividends are not deductible

49. No specific provision in part D denies a deduction for a payment that is deemed a dividend to the recipient. However, the payment of a dividend to a shareholder is generally denied deductibility because it does not have any nexus with the derivation of income or carrying on a business as required by s DA 1. Case law confirms that a distinction exists between the expenses incurred in earning profits, which are deductible, and any post-profit distribution, which is non-deductible (*Mersey Docks and Harbour Board v Lucas* (1883) 8 AC 891, (1883) 2 TC 25 (HL)). Example 15 shows this.

Example 15 – Deductibility

Dinesh is a shareholder in Dinesh's Dinners Ltd. Dinesh is not an employee of Dinesh's Dinners Ltd. Dinesh's Dinners Ltd incurs $200 paying Dinesh's private power and phone bills. This payment is discovered in a compliance review of Dinesh's Dinners Ltd a couple of years later.

The $200 of private expenditure that Dinesh's Dinners Ltd paid is treated as a dividend for Dinesh, so the expenditure is not deductible for Dinesh's Dinners Ltd. If a deduction had previously been taken for that expenditure it will be reversed as part of the review.

Amounts that are not a dividend

Employment income

50. As discussed above, where a shareholder or an associate of a shareholder is also an employee of the company and receives an amount as payment for services provided, that will not give rise to a dividend. This is because the money or money's worth provided by the company to the person (the payment) is equal to the money or money's worth provided by the person to the company (the services). In addition, even if there is a transfer of value, it will be caused by the employment relationship, and not by the shareholding. This is subject to the avoidance rules for excessive payments made to relatives, shareholders or directors (under s CD 11), discussed at [26] and in QB 14/09.

51. However, while amounts received by an employee are not treated as dividends, they do give rise to income for the employee under s CE 1. Employment income is usually in the form of cash payments. However, it can include some non-cash items. Under s CE 1, an amount derived in connection with employment or service is income if it is:
    - salary, wages or an allowance, bonus, extra pay or gratuity;
    - the value of accommodation (including accommodation allowances, payments or reimbursements) provided to a person when it is provided in relation to employment or service (ss CE 1B to CE 1E);
    - expenditure on account of an employee, being a payment made by an employer relating to expenditure incurred by an employee or to be incurred by an employee (s CE 5);
    - a benefit received under an employee share scheme (as described in s CE 2);
    - director's fees;
    - compensation for loss of employment or services; or
    - any other benefit in money.

52. Section CD 32 also confirms that the value of accommodation provided to a person in relation to employment or service which is employment income is not a dividend.

53. The amount a company incurs paying employment income will usually be a cost incurred in deriving assessable income or in the course of carrying on a business for the purpose of deriving assessable income, such that the payments will be deductible under s DA 1. However, where amounts are paid to employees who are working on a capital project, the payments may not be deductible (*Christchurch Press Co Ltd v CIR* (1993) 15 NZTC 10,206). Section DB 1 confirms that the company is also allowed a deduction for PAYE paid in relation to employment income. Example 16 shows how employment income is treated differently from dividends.

Example 16 – Employment income

Dani is a shareholder and an employee of Dani's Doughnuts Ltd. Dani receives $2,000 per month from Dani's Doughnuts Ltd.

This payment is compensation for Dani's services to Dani Doughnuts Ltd. The money transferred by Dani's Doughnuts Ltd to Dani is equal to the money's worth provided by Dani to Dani's Doughnuts Ltd. Therefore, the payment is not a dividend. However, it will be taxable employment income for Dani and will be deductible for Dani's Doughnuts Ltd.

Fringe benefits

54. Under s CD 32, a benefit provided to an employee is not a dividend if it is a fringe benefit subject to FBT.
55. A "fringe benefit" is a benefit an employer provides to an employee in connection with their employment that is (s CX 2):
    - the private use of a motor vehicle (s CX 6);
    - subsidised transport (s CX 9);
    - an employment-related loan (s CX 10);
    - a service provided to members of Parliament (s CX 12);
    - a contribution to a superannuation scheme (s CX 13), sickness, accident or death benefit fund (s CX 14), funeral trust (s CX 15), or life or health insurance (s CX 16); or
    - an unclassified benefit, being a benefit subject to FBT other than those listed above.
56. A fringe benefit is excluded income of the employee (s CX 3) and is, instead, subject to FBT under s RD 26.
57. However, if a company provides a non-cash benefit to an employee who holds shares in the company, other than a non–executive director, the company may choose to treat the benefit as a fringe benefit or a dividend (s CX 17). Section CX 17 will apply only if the benefit:
    - would have given rise to a dividend (that is, the benefit related to the shareholding); and
    - is an unclassified benefit.
58. Section CX 17 will not apply if the fringe benefit arises from the private use of asset which is subject to the mixed-use asset rules in subpart DG. If that is the case, the company must choose to treat the benefit as a dividend and not as a fringe benefit.
59. In addition, if a company provides a benefit to a person who is associated with an employee and with a shareholder in the company, and that benefit would have been a dividend if provided to the shareholder, the benefit is subject to FBT and is not treated as being a dividend (s CX 18).
60. As for other employment income, the amount a company incurs in providing benefits to employees will usually be a cost incurred in deriving assessable income or in the course of carrying on a business for the purpose of deriving assessable income such that the payments will be deductible under s DA 1. Section DB 1 confirms that the company is also allowed a deduction for FBT paid on fringe benefits.
61. Example 17 and Example 18 illustrate when fringe benefits will arise.

Example 17 – Fringe benefit

Noah is a shareholder and an employee of Noah's Needles Ltd. Noah uses a car owned by Noah's Needles Ltd for his private purposes.

Because Noah is an employee of Noah's Needles Ltd, the private use of a company vehicle will give rise to a fringe benefit rather than a dividend. Because the provision of a motor vehicle is not an unclassified benefit, Noah's Needles Ltd cannot choose to elect that the amount be treated as a non-cash dividend under s CX 17. Therefore, Noah's Needles Ltd must pay FBT on the private use of the vehicle.

Noah's Needles Ltd will be entitled to deduct the FBT paid.

Example 18 – Unclassified benefits

Jaya is a shareholder and an employee of Jaya's Jet Skis Ltd. Jaya regularly uses Jaya's Jet Skis Ltd's jet skis for her own private use.

Because Jaya is an employee of Jaya's Jet Skis Ltd, the private use of the company's property will give rise to a fringe benefit. The use of the jet skis is an unclassified benefit. Therefore, Jaya's Jet Skis Ltd can choose to treat the private use as a dividend or a fringe benefit by either including it in their FBT return for the relevant period, or complying with the withholding and other obligations that arise from paying a dividend.

Look-through companies

62. Shareholders (or persons with an "effective look-through interest" (see s HB 1(5) and YA 1)) in a look-through company (LTC) are treated as:
    - carrying on the activity carried on by the LTC;
    - holding the property that the LTC holds;
    - being party to any arrangements to which the LTC is a party; and
    - doing and being entitled to do all the things the LTC does or is entitled to do (s HB 1).
63. To that end, the shareholders in an LTC are treated as receiving all income and incurring all deductions personally. Given all income of an LTC is treated as being derived personally by its shareholders, distributions from the LTC to its shareholders are ignored for tax purposes. LTCs are also excluded from the definition of "company" in s YA 1, excluding them from the application of the dividend rules.
64. Shareholders are, however, entitled to a deduction for their share (based on their effective look-through interest) of any payments made to a working owner of the LTC (s DC 3B(1)). A "working owner" is a person who is an owner of the LTC who personally and actively performs duties that are required to be performed in carrying on the business of the LTC and are performed by the person under a contract of employment (s YA 1). The contract of employment must be in writing and must specify the terms and conditions of the services to be performed by the working owner and the amount payable for the performance of those services (s DC 3B(3)). An LTC cannot have a working owner, if the LTC is wholly or mainly engaged in investing money or in holding, or dealing in, shares, securities, investments or estates and interests in land.
65. Example 19 and Example 20 show how distributions are taxed under the LTC rules.

Example 19 – Distribution from an LTC

Chen is a shareholder in Chen's Hens Ltd, which is an LTC. Chen receives a distribution of $100 from Chen's Hens Ltd.

The distribution is ignored for tax purposes. Instead, Chen is taxed on his share of Chen's Hens Ltd's income as if he derived it directly.

Example 20 – Working owner

Kyle is a shareholder in Kyle's Smiles Ltd, which is an LTC. Kyle performs services for Kyle's Smiles under a contract of employment, which specifies the duties he is required to undertake and his salary.

Kyle's salary is a deductible expense for Kyle and the other shareholders in Kyle's Smiles Ltd.

Qualifying companies

66. While it is not possible for a company to elect to become a qualifying company anymore, qualifying companies still exist. Any dividend paid by a qualifying company to a person resident in New Zealand is exempt income of the person to the extent to which it is more than the fully imputed distribution (ss HA 14 and CW 15). Imputation credits are automatically treated as being attached to any dividend that is not a non-cash dividend (other than taxable bonus issues) to the extent that imputation credits are available (calculated at the end of the tax year) (s HA 15). Example 21 illustrates this.

Example 21 – Dividend from a qualifying company

Angelina is a shareholder in Angelina's Ballerinas Ltd, which is a qualifying company. Angelina's Ballerinas Ltd makes a distribution to Angelina of $100 during the 2021 tax year. Angelina's Ballerinas Ltd has $28 of available imputation credits at the end of the 2021 tax year.

The distribution is treated as an imputed dividend to the extent of the available imputation credits (that is, $72). The remaining distribution is exempt income for Angelina.

More examples

Example 22 - Overdrawn shareholder loan account

Alex is a shareholder in Alex's Axolotls Ltd. Alex is not an employee. On 14 June 2020, Alex borrows NZ$1,000, interest free, from Alex's Axolotls Ltd.

On 31 December 2020, Alex's Axolotls Ltd pays Alex a fully imputed dividend of $200 (gross dividend of $277.78 including imputation credits of $77.78) that is applied to repay part of the loan. Because the repayment is made in the same year that the loan was provided, Alex is treated as having made the repayment on the day the loan was originally made, and any dividend arising from the fact the loan was interest free will reduce accordingly.

When preparing the monthly management accounts for Alex's Axolotls Ltd in March 2021, its accountant notes that Alex's loan account is still outstanding and that there is the potential for a non-cash dividend to arise:

Shareholder loan account – Alex				
Date		**Debit**	**Credit**	**Balance**
1/4/20	Opening balance			0.00
14/6/20	Loan to Alex		1,000.00	1,000.00
31/12/20	Dividend	200.00		800.00

The accountant advises the directors that they have some options in terms of dealing with the tax consequences of Alex as receiving a non-cash dividend. The first option is that Alex is treated as deriving a non-cash dividend. The amount of the non-cash dividend is calculated on the outstanding balance of the loan, allowing the fully imputed dividend to be credited against the loan on 14 June 2020, the date the loan was drawn down.

$$\text{Deemed dividend} = \text{Outstanding loan x interest rate x } \frac{\text{days in quarter}}{365}$$

$$\text{Non-cash dividend Q1} = \$800 \text{ x } 5.26\% \text{ x } \frac{16}{365}$$

Non-cash dividend Q1 = $1.84

$$\text{Non-cash dividend Q2 –Q4} = \$800 \text{ x } 4.5\% \text{ x } \frac{274}{365}$$

Non-cash dividend Q2 –Q4 = $27.02

Total non-cash dividend = $28.87

Under option 1, Alex would be treated as deriving a dividend of $28.87 on the earlier of 30 September 2021 or when notified by Alex's Axolotls Ltd of the payment of the dividend. Because the accountant is preparing the accounts soon after balance date, this dividend could have imputation credits attached to it like the earlier dividend did (attaching imputation credits is discussed from [43]).

The accountant advises that option 2 is to charge Alex interest on the loan in the amount of $28.87 to 31 March 2021. This would increase the balance of the loan to $828.87 as at that date. In Alex assuming liability for this further amount, the value of the non-cash dividend would be reduced to nil.

Alternatively, the accountant advises Alex's Axolotls Ltd that as it has had a very successful year, it could just pay Alex a further dividend of $800. This dividend could be declared and paid by 31 March 2021. It could be imputed and credited back to the date the loan was drawn down.

Example 23 – FBT rules apply

Jon is a shareholder and employee of Jon's Jeeps Ltd. Jon's Jeeps Ltd allows Jon to use one of its vehicles for his private purposes. Jon does not make any payment to Jon's Jeeps Ltd in exchange for the use of the vehicle.

Is there a transfer of value?

Yes - Jon's Jeep Ltd has transferred value to Jon by allowing him to use one of its vehicles without requiring any payment in exchange.

Was the transfer caused by a shareholding?

Potentially – Jon's Jeeps Ltd would not allow a person unconnected with the company to use its vehicles. Given Jon is a shareholder in Jon's Jeeps Ltd the transfer of value could be caused by the shareholding.

Do any of the exclusions apply?

Yes – Given Jon is also an employee of the company, the private use of the vehicle would also be subject to the FBT rules. Private use of a vehicle is not an unclassified benefit.

Therefore, the benefit would be subject to FBT and not be taxed as a non-cash dividend under s CD 32.

Example 24 – FBT rules apply

Angie is a shareholder and employee of Angie's Apricots Ltd. Angie's Apricots allows Angie to take an amount of apricots home with her each night as a supplement to her salary.

Is there a transfer of value?

Yes – Angie's Apricots Ltd has transferred value to Angie by providing her with apricots free of charge.

Was the transfer caused by a shareholding?

No – Angie has been provided with the apricots as a supplement to her salary. The apricots have been provided as payment for her services and not because she is a shareholder in the company.

Therefore, no non-cash dividend will arise.

FBT consequences

However, the provision of apricots to Angie in connection with her employment will give rise to an unclassified fringe benefit, such that FBT will be payable by Angie's Apricots Ltd based on the market value of the apricots provided.

References

Legislative references

Income Tax Act 2007 – ss CB 1B – CB 1E, subpart CD (ss CD 4 – CD 7, CD 7B, CD 8, CD 11, CD 20, CD 22, CD 23, CD 23B, CD 24 – CD 29, CD 31, CD 32, CD 38 – CD 42), ss CE 1, CE 2, CE 5, CW 15, CX 2, CX 3, CX 6, CX 9, CX 10, CX 12, CX 13 – CX 18, Part D (ss DA 1, DB 1, DC 3B), GB 1, GB 23, GB 25, HA 14, HA 15, HB 1, OB 60, RD 26, RD 41, RD 54, YA 1 ("effective look-through interest", "working owner")

Case references

Abbott v Philbin (Inspector of Taxes) [1960] 2 All ER 763 (HL)

Campbell v CIR [1968] NZLR 1 (HC)

Case V9 (2001) 20 NZTC 10,101 (TRA)

Christchurch Press Co Ltd v CIR (1993) 15 NZTC 10,206

Dawson v CIR (1978) 3 NZTC 61,252 (SC)

Heaton (Inspector of Taxes) v Bell [1969] 2 All ER 70 (HL)

Mersey Docks and Harbour Board v Lucas (1883) 8 AC 891, (1883) 2 TC 25 (HL)

Stagg v CIR [1959] NZLR 1,252 (HC)

Tennant v Smith (1892) 3 TC 158 (HL)

Other references

"Deemed dividends", *Public Information Bulletin* 125 (March 1984): 6.

"QB 14/09: Income tax – meaning of 'excessive remuneration' and 'excessive profits or losses' paid or allocated to relatives, partners, shareholders or directors", *Tax Information Bulletin* Vol 26, No 9 (1 October 2014): 22. **https://www.taxtechnical.ird.govt.nz/tib/volume-26---2014/tib-vol26-no9**

IS 21/06: Income tax and GST – Treatment of meal expenses

Summary

1. The main focus of this interpretation statement is the deductibility of meal expenses by self-employed persons. But in considering that issue the statement also considers the treatment of employees. In general, self-employed taxpayers cannot deduct meal expenses for income tax purposes. This is because:

- In a broad sense expenditure on the necessities of life (meals, clothing, shelter etc) could be described as incurred by a person in deriving their assessable income for the purposes of the general permission in s DA 1 (*Hunter v CIR* (1989) 11 NZTC 6,242 at 6,258);
- However, the Act denies a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature (the "private limitation", s DA 2(2));
- An outgoing is of a private or domestic nature if it is "exclusively referable to living as an individual member of society and domestic expenses are those relating to the household or family unit" (*CIR v Haenga* (1985) 7 NZTC 5,198 at 5,207);
- Food is in the private or domestic category (*Hunter* at page 6,257, *Case E80* (1982) 5 NZTC 59,421); and
- There are limited circumstances where amounts expended on food may be deductible, such as where the requirements of a taxpayer's business imposed extra meal costs because of a remote working location or unusual working hours (*Case F117* (1984) 6 NZTC 60,125, discussed below from [28]).

2. This conclusion means there is a difference between self-employed taxpayers' meal expenses compared to:

- Employees receiving meal allowances or reimbursements while performing their duties (deductible expenditure to the employer, exempt income of the employee, not subject to FBT); or
- "Self-employed" persons incorporating a closely-held company and becoming an employee to receive the same treatment as any other employee.

3. These differences reflect the different legal arrangements in existence in these fact situations, and these different arrangements do give rise to significant legal effects. For example, there are differences in terms of personal liability, application of tax regimes (such as dividends, FBT), and so on. There is also a difference with the treatment of entertainment expenditure.

4. In the GST context, where meal expenses are of a private or domestic nature for income tax purposes, and non-deductible, input tax on the expenses cannot be deducted for GST purposes. The main reason for this is that goods and services used for private and domestic purposes are not used for making taxable supplies.

Introduction

5. The principal legislative provisions involved with the income tax issue are the general permission (s DA 1) and the private limitation (s DA 2(2)). For GST, the relevant sections of the Goods and Services Tax Act 1985 ("the GST Act") are ss 20(3) and 20(3C) dealing with the claiming of input tax.

6. For income tax the principal issue is whether a self-employed person's meal expenses are deductible, and if so in what circumstances. This statement will also compare the tax treatment of a self-employed person with the treatment of an employee receiving a meal allowance and consider the effect of the entertainment expenditure regime on the deductibility of meals.

7. For GST, the principal issue is whether input tax incurred on meals by a self-employed person is deductible, in whole or in part.

Income tax deductibility

8. The deductibility of expenditure on meals is governed by the general permission and the private limitation.

DA 1 General permission

Nexus with income

(1) A person is allowed a deduction for an amount of expenditure or loss, including an amount of depreciation loss, to the extent to which the expenditure or loss is—

(a) incurred by them in deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income; or

(b) incurred by them in the course of carrying on a business for the purpose of deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income.

DA 2 General limitations

…

Private limitation

(2) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature. This rule is called the private limitation.

Cases on the general principles

9. New Zealand courts have provided general principles for applying both the general permission and the private limitation (or their predecessor sections before they were known by such terms).

10. A good starting point for considering the general permission is the approach taken in the Court of Appeal decisions of *CIR v Banks* (1978) 3 NZTC 61,236 and *Buckley and Young Limited v CIR* (1978) 3 NZTC 61,271. In both cases the decisions of the Court were delivered by Richardson J. In *Banks* at page 61,240 his Honour said a deduction is available only where expenditure has the necessary relationship both with the taxpayer concerned and with the gaining or producing of assessable income. Relationship with the taxpayer is not sufficient as the prohibitions for deductions for capital expenditure and private and domestic expenditure make clear. The Court found there must be the statutory nexus between the expenditure and the assessable income of the taxpayer claiming the deduction.

11. *Banks* touched on the question of the character of the expenditure, which was also addressed in *Buckley and Young* at page 61,274 by Richardson J:

…The heart of the inquiry is the identification of the relationship between the advantage gained or sought to be gained by the expenditure and the income earning process. That in turn requires determining the true character of the payment. It then becomes a matter of degree and so a question of fact to determine whether there is a sufficient relationship between the expenditure and what it provided or sought to provide on the one hand, and the income earning process on the other, to fall within the words of the section (C. of I.R. v Banks (1978) 3 NZTC 61,236, 61,242).

12. The private limitation has been the subject of several court decisions including the Court of Appeal decision in *CIR v Haenga* (1985) 7 NZTC 5,198 and the High Court decision of *Hunter v CIR* (1989) 11 NZTC 6,242.

13. In *Haenga* the taxpayer, an employee of New Zealand Railways, was obliged (by statute) to make contributions to the Government Railways Welfare Society. The taxpayer claimed a deduction for the expenditure, which the Commissioner denied. The Court of Appeal upheld the decisions of the TRA and the High Court that the expenditure was deductible. Richardson J, at page 5,206, considered that in some circumstances it may be helpful to focus on the essential character of expenditure, but not always:

…In some circumstances it is helpful to focus on the essential character of an outgoing in the sense of its being incidental and relevant to the gaining or producing of the assessable income. But not always, for some expenses such as rates, repairs and travel costs are not inherently or even prima facie of either an income related or non-income related character. In other cases to label the character of the activity as private may be misleading, for example, where accommodation and meals are obtained away from home. Further analysis is required.

14. After observing that it is a matter of degree and so a question of fact to determine whether there is a sufficient nexus between the expenditure and the income earning process his Honour said (at page 5,206):

 The legal answer is complicated where, as here, the asset or advantage in respect of which expenses are incurred may serve private and income earning purposes. Thus expenses of travelling between home and work and expenses of child care have conventionally been regarded by the Courts as a private matter, a form of consumption. Inasmuch as they are a prerequisite to the earning of income it is arguable that they are incurred in the gaining of the assessable income. ***But depending on one's perspective a similar argument could even be advanced to justify deduction of outlays on such basic items as essential food, clothing and shelter which may be said to maintain and enhance the physical and psychological wellbeing of the individual, and in turn his or her ability to perform his employment. In one sense then any such expenditure has a relation to the purpose of earning income, even if it is described as an ordinary living expense. But it is not to be expected that the Legislature ever contemplated such an erosion of the income tax base in respect of employment income; and with careful emphasis on the character of the expenditure incurred the Courts have denied the notion that an expense properly characterised as consumption is incidental and relevant to the derivation of income merely because it is necessary in that sense*** *(Lodge v FC of T 72 ATC 4174 at p 4176 (1972) 128 CLR 171 at p 175; Lunney v FC of T (1957-8) 100 CLR 478). On this approach deduction may be refused in this class of case where the expenditure is of a private nature and sec 105(2)(b) and sec 106(1)(j) raise essentially the same considerations. In such a case the exclusion of expenditure made on private matters comes from the requirement of the first limb of sec 104 (and sec 105(2)(b)) which limits deductions to expenditure incurred in gaining assessable income, and the express exclusion in sec 106(1)(j) may be regarded as having been inserted by way of precaution or emphasis (Handley v FC of T 81 ATC 4165 at p 4174 (1981) 148 CLR 182 at p 200).*

 (Emphasis added.)

15. At page 5,207 his Honour said that the private limitation (then s 106(1)(j) of the Income Tax Act 1976) could be regarded as having been inserted in the Act by way of precaution or emphasis. In other words, the exclusion of expenditure made on private matters comes first from the requirement that deductions be limited to expenditure incurred in gaining assessable income. Further on page 5,207 his Honour went on to discuss what is meant by an outgoing of a private nature:

 An outgoing is of a private nature if it is exclusively referable to living as an individual member of society and domestic expenses are those relating to the household or family unit.

16. McGechan J in *Hunter* returned to the question of the denial of deductions for expenditure of a "private or domestic" nature. This arose in the context of unreimbursed relocation expenses incurred by the taxpayer during a promotion and transfer as a police officer. The deduction claimed was denied and McGechan J upheld this decision of the Commissioner.[1]

17. At pages 6,256 to 6,262 of the judgment, his Honour considered the question of whether expenditure was private or domestic. At page 6,256 his Honour referred to Richardson J's observations in *Haenga* in looking at the policy behind the denial of private or domestic expenditure:

 I look first for statutory intention. The policy underlying prohibition of deduction of expenditure of a private or domestic nature is obvious enough. It is to overcome openings otherwise available, as a matter of logic, and to protect an important tax base from undue erosion. I refer generally to the observations of Richardson J in C of IR v Haenga (1985) 7 NZTC 5,198 at pp 5,205 to 5,207; [1986] 1 NZLR 119 at pp 127-128. ***If sec 105(2) and cl 8 stood unqualified, they could permit deduction of expenditure on matters such as food, clothing, medical expenses, travel, and shelter. All, in a broad sense, would be incurred in gaining assessable income, or for the purposes of employment. One does not gain assessable income, or hold employment if starving to death, or dying from disease or exposure. On a sine qua non approach, the logic would be unanswerable. … The policy solution is prohibition of so-called personal or domestic expenditure. To say food, clothing, or shelter or the like is an essential requirement for the purposes of gaining an income might remain logical, but it is not generally to be legal. A line is to be drawn, placing beyond the pale that which "properly" is expenditure of a personal or domestic nature. No statutory definition is given. Obviously, there will be borderline cases involving line drawing. The Courts are expected to do so in a manner which promotes this statutory object.***

(Emphasis added.)

[1] McGechan J's decision in *Hunter* relating to relocation expenses was overturned by the Court of Appeal in *Hunter v CIR* (1990) 12 NZTC 7,169 on the basis that the expenditure was incurred solely for the purpose of, and as a condition of, employment and there was no private or domestic element. However, the Court of Appeal did not dispute the law applied by McGechan J and did not discuss meal expenses (as McGechan J had in the High Court). As such, the discussion from the High Court judgment is still usefully retained for his Honour's comments on meal expenses.

18. Having considered the underlying statutory policy for the prohibition, McGechan J went on to consider authority, and specific examples of expenditure which courts have considered to be private and domestic including food (at pages 6,256-7):

    I turn to authority. Traditionally, at least until recently, a conservative approach has been taken. A few examples in cognate areas will illustrate. Child minding expenses may well be a pre-requisite to the earning of income, but generally have been rejected for reasons including labelling as "private or domestic" eg Lodge v FCT (1972) 128 CLR 171 at p 176. Food, whether ordinary or exceptional to meet taxpayer needs, may be essential for a taxpayer to earn, but is regarded as in the personal or domestic category; eg Case K82 (1988) 10 NZTC 648 [also known as TRA Case 35 (1988) 12 TRNZ 444] (distinguishing at NZTC p 650; NZLR p 446 business entertainment)....

TRA cases on meal expenses

19. Meal expenses have specifically been dealt with by the TRA in a number of cases. A good starting point is the decision of Judge Barber in *Case E80* (1982) 5 NZTC 59,421. This decision undertook a comprehensive summary of the law relating to the deductibility of meal expenses. The taxpayer in question was an owner-driver of a furniture removal van who worked for a cartage contracting company. In undertaking his services, the taxpayer would at times have to stay overnight away from his home and take a number of meals "on the road". The taxpayer claimed that the meals were necessary items of expenditure incurred in producing his income.
20. From page 59,424 onwards Judge Barber discussed a number of authorities from Australia, the United Kingdom, and New Zealand on the deductibility of meal expenses. The predominant theme from these cases was that meal expenses are non-deductible as a private expense. One exception (referred to in cases discussed at page 59,245) was the meal expenditure incurred in business entertaining. (This is discussed from [71] in the context of New Zealand's statutory regime for entertainment expenditure in subpart DD.)
21. At pages 59,428 to 59,429 his Honour concluded:

    In my view there is no necessary relationship between the expenditure by O on meals and the earning of O's income. The meals were purchased by O in order to live and not to perform O's job. The expenditure was not incidental and relevant to the earning of income but was incidental and relevant to O's physical sustenance. Although the expenditure was made in the course of O's cartage jobs the expenditure was not in my view, made in the course of earning income. The expenditure was necessary for living rather than for earning income. Hence as a matter of degree I find that there is no sufficient relationship between the expenditure and what it provided and the income earning process.

    …

    I find no grounds for distinguishing between meals eaten at home and meals eaten "out of town" except perhaps where extra cost is incurred due to the taxpayer being required by his employment to eat "out of town". Although O stated in evidence that he was involved in extra cost when purchasing meals on his cartage trips, no evidence was given as to the amount or quantum of this extra cost. Nor was there any evidence that extra cost was incurred for the purpose of employment.

    I can understand and accept that there may well have been extra cost. It seems to me that, despite some dicta to the contrary in the meal cases, there may well be a sufficient statutory nexus between the extra cost of such meals and the income earning process if the quantum of the extra cost could be proved. …
22. Judge Barber referred to a possible sufficient nexus between the "extra cost" of some meals (due to their being eaten "out of town") and the income earning process. This will be discussed later in relation to another TRA case (*Case F117*). Judge Barber's comprehensive review of case law in *Case E80* included discussion of a couple of earlier TRA cases where deductibility was also denied on the "private or domestic nature" ground – *Case A12* (1974) 1 NZTC 60,088 and *Case B14* (1975) 1 NZTC 60,108. In *Case A12* a polytechnic tutor who was required to work late twice a week was refused deductibility of meal expenses for those nights he had to work late. Similarly, in *Case B14* a lecturer (at both a polytechnic and a university) was required to work late a couple of nights per week (until 7.30pm). He was unable to claim meal expenses for those evenings.
23. Judge Barber again denied meal expenses to a taxpayer in *Case P1* (1992) 14 NZTC 4,001. The taxpayer in this case was a member of an "informal partnership" of scriptwriters. The three members of the group would meet up, at the home of any one of them, to write a comedy script for a television programme. At around lunchtime they would travel to a restaurant where they would have (to quote Judge Barber) "a moderate amount of good food and wine". The bill for the lunch was divided equally between them and the taxpayer was seeking to deduct his share of the bill for a number of these lunches. Part of the taxpayer's argument was that if he had been at home working on his other writing commitments, he would have had a very modest lunch of negligible cost.

24. Judge Barber drew a careful distinction between the cost of meals to a person in their own capacity and the cost of meals incurred as entertainment expenditure. Where lunch costs were a cost of entertaining others (such as clients, customers, or employees) they might have been deductible entertainment expenditure[2]. In such a case the private benefit to the payer of the meals is regarded as incidental to the business purpose of the meal expenditure. But this was not an example of that.
25. At page 4,004 Judge Barber began his reasoning with a very strong statement of principle:

    Expenditure on food (or liquor) is not intrinsically non-deductible. However, expenditure on food for oneself, merely as sustenance, will always be private expenditure and non-deductible. Nevertheless, in the course of business or the seeking of income, there are many variations on the theme that expenditure on food (and wine or liquor) may assist business. This type of expenditure can usually be termed "entertainment expenditure". It would be a misnomer to refer to the objector's expenditure as "entertainment expenditure", because it was not spent to entertain anybody; but it seems to have been put to the respondent's Department under that concept. Entertainment expenditure, normally, is the cost to a taxpayer of entertaining others in the course of an income earning process for the genuine purpose of that process.
26. At pages 4,008 to 4,009 his Honour weighed up the conflicting arguments in favour and against deductibility and concluded that the lunches were not deductible:

    …However, on reconsidering the evidence of the objector overall, I must find as a fact that, while the lunches did create an inspirational environment which greatly assisted the script writing activity and assisted the journalists to meet deadlines and time was not lost during lunch breaks, the actual expenditure on food and liquor was made by the objector journalist to nourish and relax himself as a human being. The fact that in the course of partaking that nourishment, and enjoying that relaxing period, he and his associates continued working does not convert private expenditure on food to business expenditure.…

    I appreciate the objector's evidence that the prime purpose of the meals was not to eat with business being incidental, but to continue business with the eating being incidental. In my view, the problem is still that the expenditure on food was not to facilitate business, but to refuel and relax as a human being. I accept that the lunches were a continuation of the working process but this does not convert private expenditure into business expenditure in this case.
27. In short, the expenditure was primarily for the sustenance of the taxpayer which is generally a matter of a private nature. There was an insufficient link to the taxpayer's income earning process for deductibility. This is the general approach or position that Judge Barber took to meal expenses. However, there are a number of cases where he or other TRA judges found in favour of taxpayers being able to deduct meal expenses. Some of these are now discussed.

[2] This case predated the 1993 introduction of the limitation on entertainment expenditure which is discussed from [71].

28. *Case F117* (1984) 6 NZTC 60,125 concerned an actress who claimed, among other things, meal expenses. These meal expenses were described as "extra" expenses because of the hours of work or the requirements of her work. The actress's film set was often in the countryside so that there was often only one available eating place with food at a higher price than normal. Judge Barber summarised the situation at page 60,129 saying that "often she must stay at hotels in other cities or in another country but due to irregular filming or rehearsal hours cannot be expected to find food away from the hotel". Further:

    …Her meal allowance is modest and she now seeks some of the excess cost over that allowance. Her point is that generally when seeking a meal late at night only the more expensive meals are available when she is working away from her home. Sometimes when working in home territory her preferred home meal is spoiled by unexpected and irregular work commitments. Accordingly late at night or during a short and irregular meal break, the only practical meal to obtain is one which costs more than the normal cost of living.

29. This context of meals being consumed "away from home" calls to mind Richardson J's caveat in *Haenga* (at page 5,206). That was where His Honour said that to label the character of the activity as necessarily private may be misleading, for example meals obtained away from home. And *Case F117* (a case involving meals obtained away from home), in allowing deductions for meals demonstrates that point.

30. At page 60,129 Judge Barber explained why he considered the claim was deductible; and in this context it was important that the claim was only for extra costs:

    …I am satisfied on the balance of probabilities that the claim has been properly quantified by O's oral evidence that it relates only to extra food costs required by unusual working conditions. The claim for meals has been brought about by the circumstances under which O works as an actress. In my view there is a sufficient nexus in this case between excess expenditure on meals and O's income earning process. The only contrary approach could be that sustenance is caused by O being human, but this case involves the extra cost of sustenance caused by the nature of O's job…

31. His Honour considered that the case was consistent with his decision in *Case E80*.

32. The decision in *Case F117* can therefore be explained on the basis that the expenditure in question (the "extra" expenditure) was only incurred as a result of the taxpayer's income earning process and the peculiarities of her occupation. But for the demands or requirements of her occupation the taxpayer would not have been put to that extra cost for her meals.

33. A case where meal deductions were allowed, but which seems inconsistent with the cases previously discussed, is *Case H82* (1986) 8 NZTC 567. This case involved a university lecturer who attended a conference in Brisbane in his capacity as an employee of the university and attended another conference in Sydney in a separate capacity as a self-employed consultant. For the Brisbane conference his employer paid most of his expenses. However, for the Sydney conference he was obliged to pay his own expenses. These included an amount of $160 that he incurred in treating his friends (with whom he was staying) to dinner in appreciation of hospitality they had given him.

34. The TRA (Judge Moore) quickly found that the portion of the $160 that related to his friends' meals was private expenditure and not deductible. But the taxpayer's own meal expenses were in a different category. The taxpayer had argued that while he was away in Sydney at the conference his household expenses (including the cost of providing family meals) continued. At page 572 of the decision Judge Moore set out his understanding of the reason for the expenditure:

    The objector's expenditure on meals in the course of the Sydney conference was incurred not because the objector needed to eat but because he had good professional reasons for attending the conference and did so. Some of his work (from which he had derived income that year) was in a competition conducted in conjunction with the conference. Attendance at Sydney was not only normal participation in a professional conference but created an opportunity for the objector to exploit the business advantages inherent in having an entry in such a competition. Had the objector not attended the conference he would still have eaten but would not have had to incur the cost of meals in Sydney.

35. He drew a distinction between meal costs incurred in a taxpayer's own home compared to meal costs incurred while living away from home for income earning purposes (at pages 572-3):

    Although it is not determinative it seems to me that there is a significant difference between a claim for the cost of meals consumed at a time when the taxpayer is living in his own home (albeit not eating there on the particular occasion) and the cost of meals incurred whilst temporarily living away from home for income earning purposes. Such a distinction would not necessarily assist a taxpayer who has jobs in two different places because in effect he may have taken on a commitment to have two sets of domestic expenditure.

36. His Honour also contrasted the treatment of a self-employed taxpayer with the position of an employee receiving an allowance, and also the anomalous or unreal consequences of denying the deduction to the taxpayer:

[page 573]

Meal allowances, that is payments to employees of fixed sums of money when more than certain hours are worked, such payments being for the purpose of enabling the employee to purchase a meal, have long been accepted by the respondent as non-taxable allowances. If expenditure on meals were always of a private or domestic nature the non-taxable nature of such allowances would be difficult to justify. It is not a situation in which an employer pays for something (eg, the costs of shifting house) that would be private expenditure if the employee paid. Meal allowances are provided for in many industrial awards and are a cash payment. There is no requirement that the employee actually use such an allowance to purchase a meal.

[page 574]

It does not necessarily follow that the rules for self-employed taxpayers are or should be the same as those for employees. There are many distinctions, some of which might be seen to favour one group, some the other. In the context of the general proposition that the cost of meals must always be an expense of a private or domestic nature, the treatment within the scope of the taxation system of payments to employees for meals is relevant. Recently fringe benefit tax has been introduced to cope with what were seen as some undesirable aspects of the provision of tax-free benefits for employees but that is not a matter which need concern me here, apart from noting that the legislation has not prohibited the provision of various tax-free benefits to employees but has imposed a particular form of tax on the employer.

I am satisfied that the objector is correct when he refers to the treatment of his claim as being anomalous in the context of the conferences he attended. A self-employed person is in one sense an employee and an employer in the same person. The proposition that such a person can go to a conference with a member of his staff, they have a meal together, the employer pays for both, the employee's meal is tax deductible but the employer's meal is not, seems to me to have a degree of commercial unreality which is approaching the comic. Many persons who are in reality self-employed operate through the medium of small private companies and so avoid this particular type of problem.

37. His Honour concluded that the taxpayer's share of meal costs in relation to the Sydney conference were deductible. The costs were a part of the expenditure incurred in gaining or producing the taxpayer's taxable income. The difficulty with this case is that it is contrary to the earlier TRA decision of *Case E80*. It is also a challenging case as, unlike the taxpayer in *Case F117*, the extra expense of meals (at the restaurant) was not imposed on the taxpayer by the circumstance of his work but by his own decision to treat his friends to dinner as a sign of appreciation for their hospitality.

38. Another decision that allowed deductibility but, with respect, seems out of step with most of the case law, is Judge Barber's decision in *Case T16* (1997) 18 NZTC 8,095. In this case, a couple shifted to a new city where they bought a new home. They retained their former home which they rented out. In carrying out their rental activity, they travelled back to their former city of residence to find a suitable tenant. The visits included cleaning and maintaining the property, selecting tenants, and acquiring furniture for them. They claimed various expenses in doing so, including meals and accommodation. The Commissioner did not dispute the deduction of accommodation costs but did deny the meal expenses.

39. The Commissioner's counsel referred to earlier decisions of Judge Barber in *Case E80* and *Case P1* as support for denying the deduction of meal expenses. However, his Honour allowed the expenditure and put forward the treatment of the accommodation expenses as one of the reasons for this result. At page 8,099 he said:

I note that the respondent did not dispute deductibility for the associated cost of accommodation for the objector and members of his family. Those accommodation expenses related to the said trips to the first city in connection with the letting activity and were incurred on the same dates as the respective meal expenses. Presumably, the respondent's rationale is that the accommodation expenditure would not have been incurred unless overnight travel had been undertaken in the course of the letting activity. It seems to me that such a rationale must also apply to the meal expenditure. Also, it seems rather pinpricking to, somehow, calculate what the cost of the relevant meals for the objector (and, where appropriate, his wife and/or daughter) might have been at their home in the second city and then deduct that from the sum to be deducted for meal expenditure. I think that aspect is de minimis but may have some significance regarding the partaking of alcohol — although there is a large mark-up in the cost of alcohol in a restaurant or hotel compared with cost for home consumption.

40. On the same page he further explained why he considered the meal expenses had a sufficient link to the income earning process to be deductible:

    It seems to me that had it not been necessary for the objector (with family members) to travel to the first property to deal with its maintenance and letting, then the meal expenditure would not have been incurred. To put the matter another way, it seems to me that the meal expenditure is sufficiently linked with the letting business, or the income earning process of letting, to be a part of the overall letting activity and therefore deductible as a revenue expense of the gaining of rent.

41. This reasoning is, with respect, not convincing. To say the meal expenditure would not have been incurred in the absence of the need to travel to the rental property is out of step with the case law that has found meal expenses to be an outgoing exclusively referable to living as an individual member of society. It appears that Judge Barber has focused solely on whether the general permission was satisfied without considering whether the private limitation applied.
42. There is arguably a distinction between accommodation expenditure and meal expenditure in the circumstances of this case. Accommodation, in the sense of the person's home, is essentially a fixed cost that is incurred irrespective of the use of the home. Costs such as mortgage repayments and interest, local authority rates, insurance premiums, fixed daily costs for energy connections (etc) mean that a person has a daily cost in owning a home (a similar analysis applies for persons who rent a home). Therefore, where a person has to travel for an income earning process and incurs accommodation expenditure (such as hotel or motel accommodation) then that cost is in addition to the existing cost of accommodation the person is incurring for their home. In the absence of the travel for the income earning process the extra accommodation costs would not have been incurred.
43. Meals are different. A meal consumed in a location different to the person's usual place of residence is consumed in substitution for the meal they would have consumed in their usual location. For example, if a family is on holiday staying in a motel and prepares and consumes their evening meal at that place, it is not necessarily an additional cost incurred over and above the cost of the meal being prepared in their usual location. This is because a meal in their usual location is not being prepared and consumed at all. Another way of describing it (contrary to the view of Judge Barber in *Case T16*) is that the meal expenditure would have been incurred even if overnight travel had not been required for the income earning activities. In the example here, the family would have had to eat wherever they were based. The nature of meals being inherently private does not seem to have been considered.
44. Even in the case of accommodation there is analogous TRA case authority to the effect that accommodation would not be deductible, contrary to the decision in *Case T16*. See, for example, *Case G57* (1987) 7 NZTC 1,251 where short-term accommodation expenditure incurred to allow a taxpayer to attend to his mussel farm was not deductible. Also in *Case M128* (1990) 12 NZTC 2,825 longer-term accommodation expenditure incurred by a taxpayer working away from his family home in a different location was not deductible. In both cases meals consumed while away from home were also non-deductible.
45. However, case law provides for the possibility of deductions where the circumstances of the income earning process mean the taxpayer incurs extra costs over and above normal. *Case F117* is an example of this. Another possible example could be where a taxpayer has limited accommodation options. Perhaps the only reasonable accommodation in the vicinity of the location of the income-earning process is not self-catering or is not near a supermarket such that it is not realistic to expect a person to be able to prepare their own meals. In such a case the costs of purchasing meals may be greater than normal and therefore the extra cost deductible.
46. The sorts of factors which would lead to the deductibility (in whole or in part) of meal expenses requires some sort of objective justification. The taxpayer's personal preference will not be enough. For example, choosing to stay in a hotel without self-catering facilities (and thus having to pay for purchased meals) when other accommodation options are available will not be enough. So too, choosing not to prepare a person's own meal just because they are away from their home is not sufficient reason of itself to make a meal deductible. There must be something external to the taxpayer imposing these extra costs of the sorts discussed in the previous paragraph. In this context it is considered that the decision in *Case T16*, to the extent it suggests anything to the contrary, is out of step with the earlier court and TRA decisions.
47. The deductibility of meal expenses by self-employed persons, as can be seen from the above discussion, is not affected by whether the travel is "travel on business". Perhaps obviously if the travel was not related to the business there would be no deductibility – it would just be private travel. But even "travel on business" is not enough to give rise to deductibility of meals by the self-employed except in the limited circumstances discussed above.

Summary of the law on deductibility of meal expenses

48. In general, meal expenses incurred by a self-employed person are non-deductible because they are of a private or domestic nature. The only exception for which there is convincing authority (*Haenga* in conjunction with *Case F117*) is where the income earning process of the taxpayer requires extra meal expenses in which case that extra element will be deductible. It is considered that case law suggesting any wider deductibility, particularly TRA cases *Case H82* and *Case T16*, are inconsistent with the higher authority.

Allowances and other employee-type considerations

49. As discussed above (at paragraph 36), the TRA in *Case H82* seemed strongly influenced to allow deductibility for meals of a self-employed person by looking at the tax treatment of the meal expenses incurred by persons other than self-employed persons. In that case Judge Moore looked at the treatment of employees receiving allowances or having a meal purchased for them by their employer. He also considered a person operating through a "small private" company who is "in reality self-employed". Given these factors influenced the TRA in *Case H82* they are worth considering here.

Allowances

50. In *Case H82* meal allowances (paid in circumstances where more than certain hours were worked) were said to have been long accepted by the Commissioner as non-taxable allowances. The Act now exempts a number of types of meal allowances. Section CW 17C(1) provides that an amount an employer pays to or on behalf of an employee for a meal when the employee is working overtime is exempt income.

> **CW 17C Payments for overtime meals and certain other allowances**
>
> *Exempt income: overtime meals*
>
> (1) An amount that an employer pays to or on behalf of an employee for a meal for the employee when the employee is working overtime is exempt income of the employee.

51. Section CW 17C(2) exempts certain sustenance allowances but this subsection is relatively narrow and can be left out of the discussion here.

52. Section CW 17CB(1) provides that when the employment duties of an employee require them to work away from their employer's workplace, expenditure that the employer incurs for or on behalf of the employee for a meal for the employee is exempt income. "Expenditure" includes a reimbursement payment or a meal allowance.

> **CW 17CB Payments for certain work-related meals**
>
> *Exempt income*
>
> (1) When the employment duties of an employee require them to work away from their employer's workplace, expenditure that the employer incurs for or on behalf of the employee for a meal for the employee is exempt income of the employee. For these purposes, expenditure includes a reimbursement payment or a meal allowance.
>
> Inclusions: work-related events
>
> (2) For the purposes of subsection (1), a meal includes—
>
> (a) food and drink that the employee consumes as part of a working meal arranged as part of or as an alternative to a formal meeting for business discussions:
>
> (b) food and drink that the employee consumes at a conference or training course:
>
> (c) light refreshments in the form of snack foods such as biscuits and fruit, or liquid refreshments such as tea, coffee, water, or similar refreshments, provided for the employee, but only if—
>
> (i) their employment duties require them to be away from their employment base for most of the day; and
>
> (ii) the employer would normally provide the refreshments to the employee on the day; and
>
> (iii) it is not practicable for the employer to provide the refreshments on the day.
>
> *Inclusions: meals when travelling on business*
>
> (3) For the purposes of subsection (1), a meal also includes food and drink that the employee consumes when their employment duties require them to travel in the performance of those duties.

53. The remainder of s CW 17CB provides the detailed rules around this, including what is meant by a "meal" (s CW 17CB(2)) and meals when travelling on business (s CW 17CB(3)).

54. "Meals" includes, by virtue of s CW 17CB(2)(c), light refreshments in the form of snack foods such as biscuits and fruit, or liquid refreshments such as tea, coffee, water, or similar refreshments, provided for the employee, but only if:
    - their employment duties require them to be away from their employment base for most of the day; and
    - the employer would normally provide the refreshments to the employee on the day; and
    - it is not practicable for the employer to provide the refreshments on the day.
55. Section CW 17CB(3) provides that, for the purposes of subsection (1), a meal also includes food and drink that the employee consumes when their employment duties require them to travel in the performance of those duties.
56. Section CW 17CB(5) provides that the time limit for such meal expenses is a maximum of three months, except for expenditure under subsection (2) (light and liquid refreshments) where there is no such limit. The implication is that a wide range of expenditure on meals can be paid or reimbursed by an employer tax-free to their employee when the employee is required to work away from their employer's workplace. The only limit is the three-month maximum for an employee working away from their employer's workplace.
57. The expenses incurred by the employer in such circumstances would be deductible expenditure to the employer under s DA 1. Furthermore, s CX 5(1) provides that to the extent to which a benefit that an employer provides to an employee in connection with their employment is exempt income, the benefit is not a fringe benefit.

    CX 5Relationship with exempt income

    Exempt income not fringe benefit

    (1) To the extent to which a benefit that an employer provides to an employee in connection with their employment is exempt income, the benefit is not a fringe benefit.
58. As a result of these provisions it is important in the employer/employee context to know what it means to be working away from an employer's workplace, and what it is to travel in the performance of an employee's duties.
59. Inland Revenue has two published items of particular relevance to the question of travel "on work". The first is IS3448 *Travel by motor vehicle between home and work – deductibility of expenditure and FBT implications* (*Tax Information Bulletin* Vol 16, No 10 (November 2004)). The second is Operational Statement OS19/05 *Employer-provided travel from home to a distant workplace – income tax (PAYE) and fringe benefit tax* (*Tax Information Bulletin* Vol 32, No 1 (February 2020)). Neither of these statements concerns the treatment of meal expenses but they do address whether travel between home and work is private travel/expenditure or business/work-related travel/ expenditure. These concepts are relevant for the purposes of the exemptions in s CW 17CB. The law is well summarised at paragraphs 19 to 24 of the 2019 Operational Statement:

    19. The general rule is that home-to-work travel is private expenditure as it is expenditure to get to work and reflects the employee's personal choice as to their home location. The two main reasons for this rule are that the:
        - cost of home-to-work travel is predominantly determined by the private choices of the employee (where to live, how to get to work);
        - expense of commencing work is distinguished from expenses while "on work", and employees are expected to bear the cost of commencing work.
    20. This means the starting point is that employer-provided travel from home to work is private expenditure and would not be deductible to the employee (if employees could claim deductions). This is the case even if the employee's travel is funded by the employer or the employee's attendance at the workplace is required by the employer.
    21. **The courts have recognised exceptions to this general rule. The cases relating to deductibility of travel expenditure between home and work have identified four broad factual situations where travel between home and work is regarded as business or work-related travel. These situations are where:**
        - **a vehicle is essential for transporting goods or equipment necessary for the performance of employment duties at the home and elsewhere;**
        - **the taxpayer carries on an "itinerant occupation" (that is, the taxpayer does not work from a fixed work place, and the home is the taxpayer's base of operations;**
        - **the taxpayer is required to be accessible at their home for employment duties and is required to undertake travel in response to emergency calls;**
        - **the travel is "on work" travel between two workplaces, one of which is also the taxpayer's home.**

> 22. It can be seen from the cases that for home-to-work travel to be deductible, the employee must actually undertake work at home.
> 23. It is not sufficient to establish that the home is or can be a workplace. For expenditure to be deductible, the need for the work to be performed at the home, and, therefore, the need for the travel, must arise from the nature of the work and not from the personal choice or personal circumstances of the taxpayer.
> 24. **In addition, the actual travel must be travel undertaken in the course of performing work (that is, the travel is "on work"). If that is the case, then the cost of that travel is not private expenditure of the employee; rather, it is expenditure that would be deductible if employees were not otherwise prevented from claiming deductions.** This means the employer does not have to deduct PAYE in respect of the reimbursement or allowance, and the employee is not liable for income tax on the payments.
>
> (Emphasis added.)

60. Much of this material is not of direct relevance because the deductibility of meals is not concerned with home to work travel. But the associated notion of travelling "on work" is definitely relevant. What is meant by travel "on work" was discussed at pages 35 to 36 of IS3448 in the November 2004 TIB. The interpretation statement says that the four exceptions to the non-deductibility of travel between home and work relate to situations where travel can be regarded, in some sense, as travel in the course of performing work **rather than** travel in order to commence work or travel from work.
61. The interpretation statement summarises the general position around travel "on work" at page 36:

> *Therefore, generally travel from a taxpayer's home to the taxpayer's place of work (or to make the first business call of the day) and travel between the last business call of the day and the home would be private use, being travel to enable the taxpayer to commence work or after work has finished. Travel between the place where the first business call is made and the taxpayer's work base, or to make subsequent business calls, would be business use, being travel in the course of performing work.*

62. Operational Statement OS19/05 also specifically covers one-off or very occasional travel:

> **One-off or very occasional travel**
>
> 43. Inland Revenue considers that one-off or very occasional travel from home to a distant location for work (when required by the employer) can be treated as not taxable on an incidental or de minimis basis. For example, attendance at a two-day conference at a distant location.
> 25. This approach will apply to employees who work at an office of their employer located in their hometown as well as employees who work all the time from their home.

63. Accordingly, an employee travelling on his or her employer's business who receives a meal allowance or reimbursement is treated as receiving exempt income, and such an amount is not a fringe benefit. The employer can still deduct the cost of the allowance or reimbursement as a business expense.
64. This is in contrast to the treatment of the same type of expense incurred by a self-employed person (except in the limited circumstances discussed above for the previous issue).
65. The other two circumstances considered by Judge Moore in *Case H82* are discussed next (as mentioned above at paragraph 49).

Employer paying for meals for themselves and an employee

66. The first of these was the case of an employer paying for a meal for himself or herself and for an employee, when working away from their home base, and only being able to take a deduction for the meal expense of the employee and not their own meal. Judge Moore described this as having "a degree of commercial unreality which is approaching the comic".
67. As a matter of legal principle these different treatments are not anomalous. One is an expense incurred on an employee, and like wages or salary and other employee expenses, has a nexus with their business; s DA 1(1)(b)(i). The other expense is the employer's own personal meal expense which has regularly been found to be of a private or domestic nature.

Closely-held companies

68. The second circumstance considered by Judge Moore in *Case H82* was a case of a "self-employed" person operating through a "private company". His Honour thought that "many persons who are in reality self-employed operate through the medium of small private companies and so avoid this particular type of problem". By this it is assumed that Judge Moore meant that the company was able to deduct the cost of meals it reimburses for an "employee" (the person who is "in reality" self-employed).

69. Again, as with the first circumstance, as a matter of legal principle the difference between a self-employed person and an incorporated closely-held company is not anomalous. The company is a separate entity and expenditure it incurs in paying employee expenses has a nexus with their business; s DA 1(1)(b)(i). The fact that the company is in effect the alter ego of a self-employed person who has incorporated their activity is not relevant as a matter of legal principle.
70. It is noted that although the company can take a deduction for the cost of allowances or the provision of meals, the payment of an allowance to an employee or the provision of a meal may be taxable income to the employee or subject to FBT (as the case may be). Even where expenditure is deductible to the company, the requirements discussed above for exempting income or being outside of the scope of FBT still must be satisfied. This does not extend to private meal expenditure unconnected to work.
71. If the company is a look-through company under subpart HB of the Act then the income and expenses of the company are treated as the income and expenses of the owners of the look-through company (ss CB 32B and DV 22 of the Act). This means that a deduction for meal expenditure allowed to a "normal" company would most likely not be allowed as a deduction for the owner of a look-through interest in a look-through company as it would be private in nature.

Entertainment Expenditure

72. The other issue referred to in the TRA cases is the question of entertainment expenditure. The treatment of entertainment expenditure is covered by subpart DD of the Act. The regime was originally enacted as s 106G of the Income Tax Act 1976 with general application from 1 April 1993.

> **DD 1 Entertainment expenditure generally**
>
> *When this subpart applies*
>
> (1) This subpart applies when, in deriving income, a person incurs expenditure on entertainment that provides both a private and a business benefit.
>
> *No deduction (with exception)*
>
> (2) The person is denied a deduction for expenditure that they incur on the forms of entertainment set out in section DD 2, except for 50% of the amount that they would have been allowed in the absence of this subsection.
>
> *Meaning of limitation rule*
>
> (3) Limitation rule means the rule described in subsection (2).
>
> *Link with subpart DA*
>
> (4) This section overrides the general permission.

73. Section DD 1(1) sets out the basic principle of the regime which relates to when, in deriving income, a person incurs expenditure on entertainment that provides both a private and a business benefit. The "limitation rule" is described in s DD 1(2). A person is denied a deduction for expenditure they incurred on entertainment set out in s DD 2 ***except for*** 50 percent of the amount they ***would have been allowed*** in the absence of the subsection. This requires that the expenditure would meet the general permission in section DA 1 by having a sufficient nexus to deriving income or carrying on a business for the purpose of deriving income.
74. In *Case P1* (which was decided before the entertainment expenditure regime was enacted), Judge Barber discussed the deductibility of entertainment expenditure as a general proposition. This is relevant because the limitation rule applies to the expenditure that the taxpayer would have been able to deduct in the absence of s DD 1(2). At pages 4,008-9 his Honour said:

> *Obviously, it would only require fairly minor adjustments to the facts to create deductibility. For instance, if it had been necessary or appropriate for the journalists to entertain others as they partook these luncheons, that cost would have been deductible entertainment expenditure. Then, they would probably have been unable to progress their script writing work because they would have been devoted to the entertainment and promotion of other business aspects.* ***Strictly speaking, even in that entertainment situation, the normal cost of the taxpayer's own meal, whatever "normal cost" might be, is an ingredient of the expenditure which is non-deductible. In practice, that element is not normally isolated, presumably, because even the respondent regards it as de minimis. Also, it would hardly be worthwhile for the respondent to deny deductibility to the payer of the expenditure in that respect, because the respondent would need to isolate that taxpayer's own meal expenditure and then apportion it between his (or her) normal luncheon expenditure and the excess on each occasion for which deductibility is sought. As I said in the above extracts from Case K82, any private benefit to the payer is regarded as incidental to the business purposes of the meal expenditure.***

(Emphasis added.)

75. This suggests that a strict legal approach would be to remove a self-employed person's meal expenditure before applying the 50% limitation on expenditure. However, Judge Barber commented that the practice was not to isolate this element of the expenditure because it is *de minimis*. It also might be considered a double exclusion of the private element of expenditure. That is, if the TRA were to exclude the taxpayer's own meal expenditure in such a situation on the basis of the private limitation, and then apply the limitation rule to the remaining expenditure (and the limitation rule is designed to exclude the private benefit of entertainment expenditure) then they would have, in a sense, excluded the private benefit of meals twice. However, it must be acknowledged that there is a level of uncertainty about this in the legislation.

76. Section DD 1(4) provides that s DD 1 overrides the general permission. That is, even if the general permission had been satisfied by the entertainment expenditure it will be denied (to the extent of 50%) based on the limitation rule in subpart DD.

77. Section DD 2 describes the expenditure to which the limitation rule applies. It includes corporate boxes, holiday accommodation, pleasure craft, food and drink expenditure off premises, and food and drink expenditure on premises in certain circumstances (which are more limited compared to food and drink expenditure off premises).

> **DD 2 Limitation rule**
>
> …
>
> *Entertainment off premises*
>
> (1) limitation rule applies to deductions for expenditure on food and drink that a person provides off their business premises.
>
> *Entertainment on premises*
>
> (2) The limitation rule applies to deductions for expenditure on food and drink that a person provides, other than light refreshments such as a morning tea and whether or not guests are present,—
>
> (a) on their business premises at a celebration meal, party, reception, or other similar social function:
>
> (b) in an area of the premises that at the time is reserved for senior employees to use and is not open to all the person's employees working in the premises.

78. Section DD 4(1) provides that the limitation rule does not apply to a deduction for expenditure on food and drink consumed by a person while travelling on business or for their employment duties. However, there are limits to this exclusion.

> **DD 4 Employment-related activities**
>
> *Business travel expenditure*
>
> (1) The limitation rule does not apply to a deduction for expenditure on food or drink consumed by a person while travelling in the course of business or for their employment duties. However, the limitation rule applies if—
>
> (a) the travel is mainly for the purpose of enjoying entertainment; or
>
> (b) the food or drink is consumed at a meal or function involving an existing or potential business contact as a guest; or
>
> (c) the food or drink is consumed at a celebration meal, party, reception, or other similar social function.

79. Section DD 4(3) provides that the limitation rule does not apply to a deduction for expenditure of an amount that is exempt income under ss CW 17B, CW 17C, and CW 17CB (the latter two of which have been dealt with above).

80. Section DD 4(1) refers to the limitation rule not applying to a deduction for expenditure on food or drink consumed by a person while travelling on business (subject to the condition set out in paragraphs (a) to (c) of s DD 4(1)). It is arguable this may extend to a self-employed person, as they can be travelling in the course of business. However, even if s DD 4 did apply such that the limitation rule did not apply to the self-employed person, they still face the difficulty of having to overcome the private limitation.

81. It is difficult to draw much guidance from the treatment of entertainment expenditure. It might be said that it would be anomalous to allow a 50 percent deduction of entertainment expense where a person (other than a self-employed person) incurs entertainment expenditure, but only allow 50 percent of the net entertainment expenditure (that is, entertainment expenses less private or domestic expenditure) when a self-employed person incurs the expenditure. This might be seen as denying private expenditure twice. However, s DA 2(2) denies private expenditure and s DA 2(7) provides that each of the general limitations in s DA 2 override the general permission. Therefore, any potential deduction in s DA 1 is overridden either by the private limitation or by the limitation rule in subpart DD (and see s DD 1(4) too).

Goods and Services Tax

82. The GST input tax treatment of the meal expenses of the self-employed person follows the income tax deductibility of such expenses. That is, where it was concluded that the meal expenses were of a private or domestic nature for income tax purposes, and non-deductible, input tax on the expenses would also not be deductible for GST purposes.

83. The deductibility of input tax for GST purposes is dependent on at least three things[3]:

- There is an amount of "input tax" as defined in s 3A of the GST Act;
- The person is a registered person for GST purposes, which requires they have a taxable activity; and
- Being able to satisfy the test in s 20(3C) of the GST Act.

> **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).

84. For there to be "input tax" for a registered person in the usual case of s 3A(1)(a), means there must be "tax charged under s 8(1) on a supply of goods and services acquired by the person". This would very often be the case for meal expenses as most suppliers of meals would be registered persons who will be charging GST.

85. The self-employed person must be a registered person in order to deduct input tax.

> **20 Calculation of tax payable**
>
> …
>
> (3) Subject to this section, in calculating the amount of tax payable in respect of each taxable period, there shall be deducted from the amount of output tax of a registered person attributable to the taxable period—
>
> (a) in the case of a registered person who is required to account for tax payable on an invoice basis pursuant to section 19, the amount of the following:
>
> (i) input tax in relation to the supply of goods and services (not being a supply of secondhand goods to which section 3A(1)(c) of the input tax definition applies), made to that registered person during that taxable period:
>
> (ia) input tax in relation to the supply of secondhand goods to which section 3A(1)(c) of the input tax definition applies, to the extent that a payment in respect of that supply has been made during that taxable period:
>
> (ii) input tax invoiced or paid, whichever is the earlier, pursuant to section 12 during that taxable period:
>
> (iii) any amount calculated in accordance with any one of sections 25(2)(b), 25(5), 25AA(2)(b) or 25AA(3)(b); and
>
> …
>
> (3C) For the purposes of subsection (3), and if subsections (3D) or (3L) do not apply,—
>
> (a) input tax as defined in section 3A(1)(a) or (c) may be deducted to the extent to which the goods or services are used for, or are available for use in, making taxable supplies:
>
> (b) input tax as defined in section 3A(1)(b) may be deducted to the extent to which the goods are used for, or are available for use in, making taxable supplies other than—
>
> (i) the delivery of the goods to a person in New Zealand:
>
> (ii) arranging or making easier the delivery of the goods to a person in New Zealand.

86. The test in s 20(3C) is that, for the purposes of s 20(3) of the GST Act, input tax may be deducted to the extent to which the goods or services are used for, or are available for use in, making taxable supplies. Consuming meals in one's private capacity is not using goods or services in making taxable supplies.

87. The TRA case of *Case P5* (1992) 14 NZTC 4,034 supports the view that input tax cannot be claimed for goods to the extent that they have been acquired for private or domestic use. *Case P5* concerned the old "principal purpose" test for deducting input tax4. However, the TRA's analysis at page 4,037 can also be applied to the new test for deducting input tax:

[3] There are also administration requirements like holding a valid tax invoice (see s 20 of the GST Act).

[4] "Input tax" meant the tax charged on the supply of goods and services made to a person where those goods and services were acquired for the principal purpose of making taxable supplies.

> ***The essential problem faced by the objector, in my view, is that his main use of the vehicle was to travel from his home on the farm to his chartered accountancy practice. There can be no doubt that such type of travel is not in the course of any business or taxable activity, but is for the purpose of getting the objector from his home to his office as a chartered accountant. The law is clear that the nature of such travel is private rather than business.*** *This is because the travel is not in the course of any business but is aimed at conveying a person to the site where his business activity will commence that day.*

(*Emphasis added.*)

88. At page 4,038 the TRA concluded as follows:

    I find that the vehicle was not used for the principal purpose of making taxable supplies, and, therefore, in this case, was not acquired for that purpose. Accordingly, the input claimed is not allowable.

89. Although the case relates to the previous test for "input tax" (an all or nothing test for the initial deduction of "input tax") the conclusion would also support the view that private use of goods or services would not be used for making taxable supplies.

90. In the limited circumstances where meal expenses are deductible, on the basis the expenses are not of a private or domestic nature, then similar reasoning would allow for GST input tax deductions. That is, if the meal expenses satisfy the general permission as being incurred in the course of carrying on a business for the purpose of deriving assessable income, then the goods or services are used for making taxable supplies. Such circumstances are relatively rare.

91. If the meal expenditure is subject to the entertainment expenditure regime, then the person is deemed to have supplied entertainment with a value equal to the amount of the deduction prevented under ss DD 1 and DD 2: ss 21I(4), (4B) and (5) of the Goods and Services Tax Act 1985. This effectively means that input tax is only allowed to the extent that the entertainment expenditure regime does not apply.

Examples

84. The following examples are intended to show how the law applies.

Example 1 – Meal expenses of self-employed persons

Rob is a self-employed engineer who specialises in repairing and maintaining complex machinery and manufacturing premises. He is based in Auckland, where most of his work takes place, but he also regularly travels up to Northland and down to the Waikato and Bay of Plenty to undertake specialist repairs. On occasions he has travelled further afield when required. Rob has a small office/workshop where he stores spare parts and consumables, and where his wife works doing the admin work for the business. The office has enough space for tea and coffee facilities and a microwave.

Variation 1 – Travel around town

Rob has a busy day travelling between three client sites in South Auckland, which is a fair distance from his office on the North Shore. As a result, he does not return to his office/workshop from the beginning of the day until the end of the day as it is not practical to do so. During the day, he buys takeaway coffee on a couple of occasions and also picks up lunch from a bakery near to where he is working. Rob asks if he can claim his coffee and lunch expenses as they were incurred in undertaking his income-earning process.

Rob is unable to deduct his expenses as they are expenses of a private and domestic nature. Consistent with *Case E80* and *Case P1* these expenses were incurred to enable Rob to live rather than to earn income in the required statutory sense for s DA 1(1). The requirements of the job did not impose expenditure on Rob that would not have existed but for the job.

Variation 2 – Travel on business

The next day Rob has two jobs lined up in Rotorua. Due to the distance it takes to get to Rotorua and back, and the length of time taken to undertake the work, Rob does not make it back to Auckland until 9pm. As well as picking up a couple of cups of coffee and lunch (as in Variation 1) Rob eats his evening meal in Rotorua rather than waiting to get home. He asks whether any of his meal and drinks expenses are deductible.

Again, Rob is unable to deduct these expenses as they are expenses of a private and domestic nature. They relate to living as an individual member of society (*Haenga*), and both *Case A12* and *Case B14* support non-deductibility. However, as Judge Barber recognized in *Case E80*, extra costs may be incurred when a taxpayer is required by their work to eat "out of town". Evidence will need to be provided to indicate that such extra costs had been incurred and the quantum of such costs.

Variation 3 – Overnight travel on business

The next week Rob has two days' work in Hawkes Bay requiring him to stay a couple of nights away from home. He pays for breakfast at his motel, incurs expenditure on drinks and lunch during his working day, and eats out at a restaurant both nights he is away from his home. Is any of Rob's expenditure deductible?

On the face of it none of the meal and drinks expenditure is deductible because it is of a private and domestic nature. Rob may argue that being away from home has imposed an extra cost on him. However, his choosing to have his evening meal at a restaurant does not make Rob's working conditions sufficiently unusual as described by Judge Barber in *Case F117* when he said the taxpayer could claim extra food costs. The result is also consistent with the TRA decision in *Case G57*.

Variation 4 – Remote travel on business

A month later Rob is required to work for a couple of days on some machinery in a very remote part of New Zealand, where the only accommodation is not self-catering, and there are no supermarkets within reasonable travelling distance in any case. Rob is required to take his meals at the hotel he is staying at. Is any of Rob's expenditure deductible?

While the starting point is that meal expenditure is of a private and domestic nature, these circumstances are like those Judge Barber described in *Case F117*. Rob can argue that the cost of meals here reflects the extra food costs required by the unusual working conditions he finds himself in. The extra meal costs have a sufficient nexus with the earning of Rob's income from fixing the machinery in the remote location, and there are no practical and realistic alternatives for accommodation and meals. Accordingly, the extra cost of the meals over and above Rob's normal expenditure would be deductible. Rob calculates he would normally spend $15 on his evening meal, so any cost above this is deductible.

Variation 5 – Employee expenses

Rob employs Esther to help with the workload in his business. Esther has two days' work in Hawkes Bay requiring her to stay a couple of nights away from home. Pursuant to the terms of her employment contract, Rob reimburses Esther for her meal expenses and also pays her a daily amount for light and liquid refreshments. How should Rob treat the payments to Esther for meals?

As an employee expense Rob, will be able to deduct the amounts he is obliged to pay Esther under the employment contract. The private limitation will not apply to this expenditure. Rob should also treat the payments to Esther as exempt income either under section CW 17CB(2) (for the light and liquid refreshments) or section CW 17CB(3) (for reimbursements for meals).

Example 2 – Meal expenses of employees

Darlene is also an engineer who specialises in repairing and maintaining complex industrial machinery. She is employed by Fix It Quik Limited. Her place of work is Fix It Quik Limited's work premises in Upper Hutt, but most of her work is undertaken at the premises of the customers of Fix It Quik Limited. As such she only spends time at her work premises at the beginning and end of the day, and if she needs to pick up spare parts or consumables during the day.

Variation 1 – employee allowances

Darlene has a full day travelling between five client sites in Wellington, a good distance from Fix It Quik Limited's office in Upper Hutt. She does not check back into the office until the end of her working day. During the day she has bought a couple of takeaway coffees, and also buys lunch at a lunch bar near where she is working. Fix It Quik Limited pays Darlene a daily allowance of $15.00 to cover the costs of "light refreshments" and "liquid refreshments" which she would be able to enjoy if she was working at Fix It Quik Limited's premises. The payment is for those days when she is working off premises. How should Fix It Quik Limited and Darlene treat this payment?

Section CW 17CB allows payments for certain work-related meals to be exempt income. The payment can include a reimbursement payment or a meal allowance. Under s CW 17CB(2)(c) a "meal" includes light refreshments in the form of snack foods such as biscuits and fruit, or liquid refreshments such as tea, coffee, water, or similar refreshments.

Under s CW 17CB(5) there is no time limit on expenditure incurred for meals covered by s CW 17CB(2) (for other meals there is a three month time limit). Accordingly, for Darlene the daily payments received are exempt income. For Fix It Quik Limited the expenditure is deductible as an expense incurred in the course of carrying on a business of deriving their assessable income (s DA 1(1)(b)). The private limitation does not apply to a company, so even though the expenditure relates to an employee's "meals" the expenditure is not denied under the private limitation.

Variation 2 – employee reimbursements

The next day Darlene has two jobs in Taihape. Due to the distance to get to Taihape and back and the length of time taken to undertake the work, Darlene does not get back home until 9pm. As well as buying a couple of cups of coffee and lunch (as in Example 1, Variation 2) Darlene eats her evening meal in Palmerston North rather than waiting to get home. Fix It Quik Limited's work policy is to cover all meal costs when employees are sent on such "out of town" jobs. How should Darlene and Fix It Quik Limited treat the reimbursement payments for meals, light refreshments, and liquid refreshments?

For Darlene, as in Variation 1, any payments for coffee and light refreshments will be exempt income under s CW 17CB(2). The payment for lunch will be exempt income under s CW 17CB(3) ("meals when travelling on business"), and the payment for dinner is exempt income under either s CW 17C(1) (payment for overtime meals) or under s CW 17CB(3) for the same reason as the payment for lunch. For Fix It Quik Limited the expenditure is deductible for the same reasons as in Variation 1, and similarly the private limitation does not apply to deny the deduction.

Variation 3 – employee travelling out of town on business

The next week Darlene is sent to Timaru for two days (and two nights) to service and repair some machinery. While she is in Timaru she stays at a motel with full kitchen facilities. Fix It Quik Limited reimburses Darlene for her meals while she is in Timaru according to company policy, and also pays a daily amount for light refreshments and liquid refreshments. Darlene claims reimbursement for lunch and dinner, and she eats out rather than preparing her own meals at the motel. How should Darlene and Fix it Quik Limited treat the payments for meals, light refreshments, and liquid refreshments?

For Darlene, as in Variations 1 and 2, any allowance she receives for coffee and light refreshments will be exempt income under s CW 17CB(2). The reimbursements for lunch and dinner will be exempt income under s CW 17CB(3). If Darlene is just working normal hours while in Timaru the payments she receives will not come within the rules for overtime meals under s CW 17C(1). For Fix It Quik Limited the expenditure is deductible for the same reasons as in Variations 1 and 2, and similarly the private limitation does not apply to deny the deduction.

Variation 4 – employee's remote travel on business

A month later Darlene is required to spend a couple of nights on a remote offshore island to repair and maintain machinery. The only accommodation at the island is a luxury resort. There is no self-catering accommodation and no supermarkets on the island. Darlene is paid an allowance for light refreshments and liquid refreshments and is reimbursed for the cost of all meals. How should Darlene and Fix It Quik Limited treat the payments for meals, light refreshments, and liquid refreshments?

There is no difference in this example from Variation 3. The reimbursing payments and allowances are exempt for Darlene and the payments are deductible to Fix It Quik Limited.

Example 3 – Entertainment expenditure for self-employed

Variation 1 – providing hospitality for clients

Rob is finding that his market for machinery repair and maintenance in Auckland is under threat from a newcomer in the form of Fix It Quik Limited. Rob decides he needs to work harder on maintaining customer loyalty and begins taking the key people at his most important clients out to dinner. Every Wednesday night he takes one group out for dinner and drinks. Rob asks if he can claim a deduction for the expense of providing this hospitality to his clients.

Rob's deduction of expenses will be subject to the entertainment expenditure regime in subpart DD of the Act. The expenditure is covered by the regime by virtue of s DD 2(5) (deductions for expenditure on food and drink that a person provides off their business premises). The operative rule for entertainment expenditure is in s DD 1(2). This provides that the person is denied a deduction for expenditure that they incur on entertainment except for 50% of the amount that they would have been allowed in the absence of s DD 1(2). But for the entertainment expenditure rules Rob would have been allowed a deduction for the hospitality expenditure he has incurred (treating the private benefit of a meal to Rob as incidental to the business purpose, *Case P1).* Therefore, section DD 1(2) allows Rob to claim 50% of the full meal expenditure incurred in taking his clients out for dinner.

If Rob had just been eating out by himself, he would not have been able to deduct any amount of the meal expenditure. It may seem anomalous that by eating out with business contacts he is, in effect, able to deduct 50% of his meal. However, the limitation rule means that Rob is unlikely to be in a better overall position under the entertainment expenditure regime as he will be denied 50% of the deduction he would have otherwise been allowed for the expenditure incurred for his customers.

Variation 2 – providing hospitality to friends

On a Friday night Rob often gets together with a group of other self-employed persons from the business park where his office/workshop is located. They go to a local bar and have a few drinks and often a meal too. Rob's friends Brent and Richard have been struggling financially recently as a result of a downturn in business so Rob shouts them a meal at the bar, and also pays for a round of drinks for them and the rest of the group. Rob asks if he can claim a deduction for the expense of providing these meals and drinks. He also asks if the entertainment expenditure regime applies.

Rob cannot deduct the cost of providing meals to his two friends (and himself) and for shouting a round of drinks to the group. Such expenditure has no nexus to either deriving his income or to carrying on his business for the purpose of deriving income. It is a private expense and does not satisfy the general permission.

As for the entertainment expenditure regime, because the expenditure would not have been allowed in the absence of section DD 1(2) there is no ability to claim 50% of the expenditure under that regime.

Example 4 – Entertainment expenditure for employers

Fix It Quik Limited realises that to break into the lucrative Auckland machinery repair market it needs to "wine and dine" the key people at certain industrial plants. Darlene is sent to Auckland to introduce herself to some of these key people and to take them out for dinner and drinks. Can Fix It Quik Limited deduct all the costs of the hospitality provided?

The limitation rule in s DD 1(2) of the entertainment expenditure regime applies in the same way for Darlene and Fix It Quik Limited as it did for Rob in Example 3. The expenditure on the meals and drinks is entertainment expenditure under s DD 2(5) and only 50% of the expenditure is allowed by s DD 1(2). Section DD 4(1) provides that the limitation rule does not apply for expenditure on food or drink consumed by a person while travelling in the course of business or for their employment duty. However, the limitation rule continues to apply if, among other things, the food or drink is consumed at a meal or function involving an existing or potential business contact as a guest (s DD 4(1)(b)) as is the case here. This same principle applies for Rob in Example 3.

Example 5 – Meal expenses of a shareholder-employee

Meg and John are the only shareholders of Brooke's Books Limited, a provider of bookkeeping services. Meg is employed by the company and often travels to conferences and seminars to promote the business. Pursuant to her employment agreement with the company, she is entitled to reimbursement for her meal expenses while away from home on company business and is also entitled to a daily allowance for light refreshments and liquid refreshments. On Meg's most recent business trip to a conference, John also attends to get a better idea of what occurs at these type of events and the company pays for all his meal expenses as well. John is not an employee of the company and is not related to Meg.

How should Brooke's Books Limited treat the payments it makes to Meg and John for their meals?

As Meg is genuinely undertaking her employment duties for Brooke's Books Limited, the treatment of her expenditure would be the same as the treatment of Darlene in Variation 3 of Example 2. That is, the allowance for light and liquid refreshments can be treated as exempt income of Meg under section CW 17CB(2), and the reimbursements for meals will be exempt income under section CW 17CB(3). The amounts paid will be deductible to Brooke's Books Limited and the private limitation will not apply.

In John's case none of the exempt allowance provisions can apply as John is not an employee of the company. Instead, the payment of John's meal expenses by the company is likely to give rise to a deemed dividend (see interpretation statement IS 21/05 "Non-cash dividends", paragraph 20 and example 5, for more discussion of this issue).

References

Case References

Court decisions

Buckley and Young Limited v CIR (1978) 3 NZTC 61,271 (CA)

CIR v Banks (1978) 3 NZTC 61,236 (CA)

CIR v Haenga (1985) 7 NZTC 5,198 at 5,207 (CA)

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Case A12 (1974) 1 NZTC 60,088

Case B14 (1975) 1 NZTC 60,108

Case E80 (1982) 5 NZTC 59,421

Case F117 (1984) 6 NZTC 60,125

Case G57 (1987) 7 NZTC 1,251

Case H82 (1986) 8 NZTC 567

Case M128 (1990) 12 NZTC 2,825

Case P1 (1992) 14 NZTC 4,001

Case P5 (1992) 14 NZTC 4,034

Case T16 (1997) 18 NZTC 8,095

Legislative References

Income Tax Act 2007

Sections CW 17C, CW 17CB, CX 5, DA 1, DA 2(2), Subpart DD

Goods and Services Tax Act 1985

Sections 3A, 20(3), 20(3C)

QUESTION 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 21/05: The application date for the depreciation of commercial buildings

Question

When do the new rules providing for the depreciation for commercial buildings apply from: 1 April 2020 or from the beginning of the 2020 – 2021 income year?

Answer

The new rules for depreciation for commercial buildings apply from the beginning of the 2020-21 income year for all taxpayers.

Explanation

1. Prior to the passing of the COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020 (the Amendment Act), taxpayers were not able to claim a depreciation loss in respect of any building. By amending the existing legislation and making this limitation specific to residential buildings, the amendment now allows owners of commercial buildings to claim depreciation[5].
2. Unless it is anticipated that an Act will commence on the day after it is given Royal Assent, all Acts must be given a commencement date.[6] The commencement date is the day that the Act comes into force.
3. In the case of the Amendment Act, the commencement date is stated as being the date on which it was given Royal Assent, EXCEPT in relation to some specific sections[7]. These excepted sections include the sections that allows depreciation to now be claimed on commercial buildings. The commencement date for these sections is stated to be 1 April 2020[8].
4. Having a commencement date of 1 April can be problematic for a taxpayer with a balance date prior to 1 April as it would mean that the legislation would only apply for part of their 2020 – 2021 income year. To overcome this, it is quite usual to supplement the commencement date to ensure that the relevant provisions apply from the beginning of a particular income year (no matter what balance date a taxpayer has). In this instance, having the provision apply from the beginning of an income year means that taxpayers with early balance dates are not disadvantaged or inconvenienced by, for instance, having to undertake apportionment of the depreciation loss.
5. In the case of the Amendment Act, the amendments specific to commercial building depreciation are stated as applying "for the 2020-21 and later income years"[9].
6. This is consistent with statements made in the commentary to the Amendment Act, which stated that the proposed amendment would apply for the 2020–21 income year.
7. This result is also consistent with statements made in the commentary to the Amendment Act regarding the repeal of s DB 65. This section previously allowed a deduction for commercial fit-out not previously separately depreciated. With the reintroduction of depreciation on commercial buildings s DB 65 is no longer required. As with the statement made in the commentary discussed at [6], the commentary to the Amendment Act that discusses the repeal of s DB 65 states that the section is repealed with effect from the 2020 – 21 income year.

[5] Sections EE 31, EE 31(2)(d) and EE 31(3)(c) of the Income Tax Act 2007.

[6] Section 8 of the Interpretation Act 1999.

[7] Section 2(1) of the Amendment Act.

[8] Section 2(5) of the Amendment Act.

[9] Section 5(4) of the Amendment Act.

Examples

8. The following examples illustrate when the new rules reintroducing depreciation for commercial buildings will apply from.

Early balance date

Early Worm Limited has a 30 November balance date.

The new rules reintroducing depreciation for commercial buildings will apply from 1 December 2019, which is the first day of the company's 2020-21 income year.

Standard balance date

Ordinary Limited has a 31 March balance date.

The new rules reintroducing depreciation for commercial buildings will apply from 1 April 2020, which is the first day of the company's 2020-21 income year.

Late balance date

Night Owl Limited has a 30 June balance date.

The new rules reintroducing depreciation for commercial buildings will apply from 1 July 2020, which is the first day of the company's 2020-21 income year.

References

Legislative References

COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020 – ss 2, 4, 5, 6, 7, 10, 11, 12, 13, 14, 29(2) and (4) to (8), 30 and 39

Income Tax Act – s EE 31 and YE 1

Interpretation Act 1999 – s 8

QB 21/06: Income tax – tax treatment of cryptoassets received from an airdrop

Question

What are the income tax consequences of receiving cryptoassets from an airdrop?

Answer

The receipt of airdropped cryptoassets is taxable where a person:

- has a cryptoasset business;
- acquired the cryptoassets as part of a profit-making undertaking or scheme;
- provided services to receive the airdrop (and the cryptoassets are payment for the services provided); or
- receives airdrops on a regular basis, and the receipt has hallmarks of income.

In other cases, the receipt is not taxable.

The disposal of airdropped cryptoassets is taxable where a person:

- has a cryptoasset business;
- disposed of the cryptoassets as part of a profit-making undertaking or scheme;
- provided services to receive the airdrop; or
- acquired the cryptoassets for the purpose of disposing of them.

In many cases, the disposal will be taxable. However, in some cases outlined in this item, airdropped cryptoassets may be passively acquired and will not be acquired for the purpose of disposal.

Key terms

Airdrop is described at [1] below.

Cryptoassets are cryptographically secured digital representations of value that can be transferred, stored or traded electronically. They use some form of distributed ledger technology such as blockchain. Cryptoassets may also commonly be referred to as cryptocurrencies, digital tokens or virtual currencies.

Cryptoasset business is a business that uses cryptoassets as part of its day-to-day activities, such as an exchange, a cryptoasset dealing business or a mining business.

Disposal includes selling cryptoassets for money, exchanging them for other cryptoassets or using them to acquire goods or services.

Explanation

What is an airdrop?

1. Airdrops are "the distribution of tokens without compensation (i.e. for free), generally undertaken with a view to increasing awareness of a new token, particularly amongst 'influencers', and to increase liquidity in the early stages of a new token project".[10] For example, the purpose of an airdrop may be to:
   - increase the supply of a cryptoasset in the market;
   - reward early investors or users; or
   - raise awareness of a new cryptoasset by distributing that cryptoasset to holders of other cryptoassets.

[10] OECD *Taxing Virtual Currencies, an Overview of Tax Treatments and Emerging Tax Policy Issues* (OECD, Paris, 2020) at 1.2.2. For the avoidance of doubt, this item does not apply to the receipt of new cryptoassets from a hard fork which is addressed in a related item, QB 21/07.

The ways a person may be entitled to receive an airdrop

2. The ways people become entitled to receive airdrops of cryptoassets differ. For example:
   - Early users of a platform may be rewarded for previous use (for example, in the Uniswap airdrop, users of a decentralised exchange received airdrops of UNI tokens if they had provided liquidity or traded on the exchange before a specified date).
   - People who hold one type of cryptoasset may receive airdrops of another type of cryptoasset (for example, in the Ontology airdrop, people who held NEO tokens at a specified date were airdropped ONT tokens).
   - Airdrops of cryptoassets may also be received by people who undertake minor tasks such as following the cryptoasset on social media, making referrals or signing up to an airdrop or newsletter (for example, Stellar Lumens (XLM) were airdropped to blockchain.com wallet holders who signed up to the airdrop and verified their identity, and ONT tokens were airdropped to people who signed up to a newsletter).

The ways a person may claim airdropped cryptoassets

3. The steps required to claim an airdrop once a person is entitled to it depend on the circumstances. For instance, a person may need to:
   - click to claim the airdropped cryptoassets and pay a transaction fee (for example, UNI);
   - download a new wallet and pay a transaction fee (for example, ONT); or
   - do nothing further (for example, blockchain.com wallet holders who received XLM).

Is the receipt of airdropped cryptoassets taxable?

4. When a person receives airdropped cryptoassets, the first question is whether that receipt is taxable. As explained below, in most cases the receipt of airdropped cryptoassets is unlikely to be taxable.

Business income

5. An amount a person derives from a business is their income unless the amount is of a capital nature (s CB 1). An "amount" includes money's worth. Cryptoassets, while not money, are money's worth, so the receipt of cryptoassets could be an amount derived from a business. The question is whether the amount is derived from the current operations of the business, in the ordinary course of the business, or as an ordinary incident of the business.[11] The answer to this question depends on the nature of the business and its relationship with the cryptoassets.
6. The receipt of airdropped cryptoassets is likely to be in the ordinary course, or an ordinary incident, of cryptoasset businesses (such as mining or dealing businesses) but would not generally be an ordinary incident of other types of businesses. Whether receipt occurs in the ordinary course, or as an ordinary incident, of a business will depend on the type of business and the way in which it earns income. The receipt of airdropped cryptoassets would be taxable if the receipt could be said to be part of the way in which the business earns its income.
7. Airdropped cryptoassets may form part of the trading stock of a cryptoasset business if they are held for sale or exchange in the ordinary course of the business.

Profit-making undertaking or scheme

8. An amount a person derives from a profit-making undertaking or scheme is income of the person (s CB 3). An undertaking or scheme is a series of steps directed to an end result. There needs to be a plan or purpose that is coherent and has some unity of conception. The undertaking or scheme must be carried out for the dominant purpose of making a profit.[12]
9. The receipt of airdropped cryptoassets could be income from a profit-making undertaking or scheme if the person has a plan directed at acquiring airdropped cryptoassets with the dominant purpose of making a profit.

Income under ordinary concepts

10. An amount may also be taxable if it is income under ordinary concepts (s CA 1(2)). Income is commonly described as something that "comes in" to a person. Factors relevant for deciding whether something is income include whether payments are regular or recurrent, the relationship between the payer and payee, and the purpose of the payment.[13]

[11] *CIR v City Motor Service Ltd; CIR v Napier Motors Ltd* [1969] NZLR 1,010 (CA) and *AA Finance Ltd v CIR* (1994) 16 NZTC 11,383 (CA).

[12] *Investment & Merchant Finance v FCT* (1970) CLR 177 (HCA); *Vuleta v CIR* [1962] NZLR 325 (SC); *Duff v CIR* (1982) 5 NZTC 61,131 (CA) and *Case S86* (1996) 17 NZTC 7,538 (TRA).

[13] See *Tennant v Smith* (1892) 3 TC 158 (HL); *CIR v Grover* (1988) 10 NZTC 5,012 (CA) and *Reid v CIR* (1985) 7 NZTC 5,176 (CA).

11. Where airdrops are not regular and where no relationship exists between the payer and recipient (for example, the recipient has not performed services to receive the airdropped cryptoassets), the receipts would not generally be ordinary income.

Summary

12. The receipt of airdropped cryptoassets will be taxable where the cryptoassets are received:
    - by a cryptoasset business (if received as an ordinary incident of the way in which the business earns its income);
    - as part of a profit making undertaking or scheme; or
    - by a person who has provided services or receives airdrops on a regular basis such that the airdrops have the hallmarks of income.
13. In other cases, the receipt is not taxable.

Is the disposal of airdropped cryptoassets taxable?

14. The second question is whether a disposal of airdropped cryptoassets is taxable. As discussed below, whether a disposal is taxable will depend on the person's circumstances.

Business income

15. Amounts received from disposing of airdropped cryptoassets will be taxable income of cryptoasset businesses (such as mining and dealing businesses) as the disposal will likely be the sale of their trading stock or otherwise income from a business.
16. The disposal of airdropped cryptoassets by other types of businesses is unlikely to be taxable under s CB 1, unless disposing of cryptoassets is something that occurs in the ordinary course of the business. However, the disposal may still be taxable under other provisions such as s CB 4.

Profit-making undertaking or scheme

17. There may be instances where the disposal of airdropped cryptoassets is part of a profit-making undertaking or scheme, in which case the amount derived from the disposal will be income under s CB 3. This will be fact specific.

Acquired for the purpose of disposal

18. An amount derived from disposing of personal property is income if the person acquired the property for the purpose of disposing of it (s CB 4). The decision in *Ruscoe* clarified that cryptoassets can be property.[14]
19. For s CB 4 to apply, disposal must be the person's dominant purpose for acquiring the property.[15] The Commissioner's general position is that, in most cases, cryptoassets will be acquired for the purpose of disposal and a person will need to provide clear and compelling evidence to show otherwise.[16]
20. Where a person passively acquires property, for example, by inheritance or gift, they generally do not have a purpose when acquiring that property. However, a person will not be regarded as a passive recipient where they have turned their mind to the acquisition or provided consideration.[17]
21. A person acquires cryptoassets from an airdrop when the person has possession and control of the cryptoassets and can deal with them. This is when the person holds the private key (or otherwise holds the cryptoassets on an exchange). Accordingly, all steps and actions of the person up until that time are relevant for determining what the person's purpose was when that cryptoasset was acquired. At that time, the person generally has had to turn their mind to completing an action to become entitled to receive an airdrop.

Situations where a person turns their mind to acquiring airdropped cryptoassets

22. As previously stated, a person may receive an entitlement to an airdrop for performing various small tasks such as signing up to airdrops, opting in, making referrals and mentioning the cryptoasset on social media. They may also need to acquire particular types of cryptoassets or download wallets in order to be eligible for an airdrop.

[14] *Ruscoe v Cryptopia Ltd (in liq)* [2020] NZHC 728 (HC).

[15] *CIR v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA).

[16] See Inland Revenue, *Cryptoassets* (**https://www.ird.govt.nz/cryptoassets**).

[17] Case F41 74 ATC 227 (Board of Review); *FCT v Miranda* 76 ATC 4180 (NSWSC); *Tikva Investments Pty Ltd v FCT* 72 ATC 4,231 (HCA).

23. When a person has had to take these types of steps, whether by acquiring cryptoassets or wallets to be eligible for an airdrop, or performing small tasks or signing up to something, they have turned their mind to the acquisition of the cryptoassets and will have a purpose in acquiring the cryptoassets. Section CB 4 will apply if the person acquired the airdropped cryptoassets for the purpose of disposal.
24. As noted at [21], because a cryptoasset is acquired for tax purposes when a person has control over it, all the steps taken up to that time are relevant for determining whether they have a purpose at the time of acquisition. A purpose can be determined where the person has had to turn their mind to acquiring the cryptoassets in some way. This includes situations where the person:
    - acquires cryptoassets in advance of an airdrop, in order to be entitled to the airdrop;
    - uses a platform with the expectation or knowledge that they might receive an airdrop;
    - transfers their cryptoassets to a supporting wallet to ensure they are eligible for an airdrop;
    - signs up, opts in, joins a newsletter, mentions the cryptoasset on social media or does other minor tasks in order to be eligible to receive the airdrop.

    In these cases, s CB 4 will apply where the person's purpose in acquiring the airdropped cryptoassets is to dispose of them.

Situations where a person has not had to turn their mind to claim the cryptoassets

25. It is possible that a purpose may not be able to be determined in some limited cases. This includes where a person:
    - receives airdropped cryptoassets to their existing wallet simply because they already held that type of wallet, or a type of cryptoasset, and did not have to do anything to be entitled to them or claim them; or
    - had previously used a platform without any knowledge of an airdrop occurring, received an airdrop because of those previous actions, and only had minimal steps to claim the cryptoassets (such as clicking to claim the cryptoassets).
26. In these types of events, whether a purpose can be established depends on the extent to which the person knew of an airdrop, and also whether they needed to do anything further to claim the cryptoassets (such as signing up or opting in, downloading new wallets or other tasks). If the person simply needs to click to claim the cryptoassets, this is not likely, in and of itself, to be enough for the person to have turned their mind to the acquisition.[18] For completeness, if a person starts actively undertaking tasks (such as using platforms) hopeful for an airdrop, they have likely done enough for their acquisition to be considered active.

Summary

27. Whether the disposal of airdropped cryptoassets is taxable depends on the circumstances. The disposal will be taxable where the person:
    - has a cryptoasset business;
    - disposed of the cryptoassets as part of a profit-making undertaking or scheme;
    - provided services to receive the airdrop; or
    - acquired the cryptoassets for the purpose of disposing of them.

Are any deductions available?

28. The third question is whether deductions are available if any amounts are taxable. As discussed below, generally no deductions are available as no expenditure is usually incurred in acquiring airdropped cryptoassets. However, deductions will be available where cryptoassets are taxed on receipt and also on disposal.

The cost of the cryptoassets

29. Where the receipt or disposal of cryptoassets is taxable, deductions for expenditure incurred may be available (s DA 1 or s DB 23). However, other than transaction fees, no other expenditure is incurred when a person receives cryptoassets from an airdrop. Therefore, no deduction (other than for transaction fees) will generally be available.
30. However, when a person is taxed on both the receipt and disposal of a cryptoasset then a deduction for the cost of the cryptoasset is available at the time of disposal (ss DB 23 and EA 2). Where a person is taxed on receipt and disposal, the cost of acquiring that cryptoasset can take into account the value of the cryptoasset at the time of receipt (which the person paid tax on). Allowing a cost for this amount ensures the person is not effectively taxed twice on the initial value of the cryptoasset.[19]

[18] See for example Case F41 74 ATC 227 (Board of Review) where the taxpayer did not "exercise his mind in any way to acquire rights".

[19] This is considered consistent with comments made in *Tasman Forestry Ltd v CIR* (1999) 19 NZTC 15,147 (CA), *Sharkey v Wernher* [1956] AC 58 (HL); *Halliwell v CIR* (1991) 13 NZTC 8,197; and *Rangatira Ltd v CIR* (1996) 17 NZTC 12,727.

Trading stock rules

31. Airdropped cryptoassets that form trading stock of a business may also be taxable on receipt and on disposal. For the same reasons as above, a person who holds trading stock that is taxable both on receipt and on disposal may claim a deduction for the cost of those cryptoassets, relating to the value on receipt (which the person paid tax on). This deduction may be claimed in the year the receipt is returned as income. The person must then value the trading stock at the end of each income year under the trading stock rules (in Part E of the Act).
32. Standard valuation methods apply to the valuation of trading stock. There are no special rules for cryptoassets, so a person may use whatever method is available to them. However, the value of any trading stock that is an excepted financial arrangement must be valued at cost.[20] If a person uses a different method, they must satisfy all the requirements of the method. There may be difficulties in satisfying methods that refer to a normal value of property (or an amount that would be expected to be received) due to the volatility of cryptoasset prices.

Examples

Example 1: Beth signs up for airdrops

Beth had been following some recent airdrops. She started signing up to upcoming airdrops that she read about online, hoping she could make some money from them.

Beth received small airdrops from signing up online to projects, but the transaction fees were too expensive, so she never took any steps to acquire them. The cryptoassets from those airdrops have not been acquired and there are no tax consequences.

Beth read about an upcoming airdrop where holders of ABC tokens would receive airdrops of DEF tokens. Beth thought the DEF airdrop sounded like it could be a good deal, and so she acquired the ABC tokens and signed up to the airdrop which included filling in some personal information for Know Your Customer purposes. Beth received an airdrop of 350 DEF tokens and claimed them. This receipt is not taxable.

Several months later, the DEF tokens had increased in value, so Beth exchanged all her DEF tokens for ETH and immediately cashed out.

This disposal of the DEF tokens is taxable under s CB 4. Beth had turned her mind to acquiring the DEF tokens and did so for the purpose of disposing of them.

Example 2: Beth receives airdrops unexpectedly

A year later, a further airdrop of ABC-Z tokens was announced to all holders of ABC tokens. Beth still held her ABC tokens. She had given up on airdrops as they were not as lucrative as she had hoped.

Beth did not need to do anything to receive the ABC-Z airdrop as she already held the ABC tokens, and the ABC-Z airdrop did not require a person sign up or opt in. She only had to click a button to claim them. Beth did not acquire the ABC-Z tokens for the dominant purpose of disposal in this instance as she did not have to turn her mind in any way to receiving the ABC-Z tokens. Accordingly, any subsequent disposal of the ABC-Z tokens would not be taxable under s CB 4.

[20] Cryptoassets are currently proposed to be included as excepted financial arrangements (with retrospective effect), so cost appears the most appropriate valuation method. Cost will be the only appropriate method once any legislative change is enacted.

References

Legislative references

Income Tax Act 2007 – ss CA 1(2), CB 1, CB 3, CB 4, DA 1, DB 23, EA 2

Case references

AA Finance Ltd v CIR (1994) 16 NZTC 11,383 (CA)

Case F41 74 ATC 227 (Board of Review)

Case S86 (1996) 17 NZTC 7,538 (TRA)

CIR v City Motor Service Ltd; CIR v Napier Motors Ltd [1969] NZLR 1,010 (CA)

CIR v Grover (1988) 10 NZTC 5,012 (CA)

CIR v National Distributors Ltd (1989) 11 NZTC 6,346 (CA)

Duff v CIR (1982) 5 NZTC 61,131 (CA)

FCT v Miranda 76 ATC 4180 (NSWSC)

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Ruscoe v Cryptopia Ltd (in liq) (2020) 5 NZTR 30-001 (HC)

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Other References

Inland Revenue, *Cryptoassets* (**www.ird.govt.nz/cryptoassets**)

OECD *Taxing Virtual Currencies, an Overview of Tax Treatments and Emerging Tax Policy Issues* (OECD, Paris, 2020). **www.oecd.org/tax/tax-policy/taxing-virtual-currencies-an-overview-of-tax-treatments-and-emerging-tax-policy-issues.pdf**

QB 21/07: Income tax – tax treatment of cryptoassets received from a hard fork

Question

What are the income tax consequences of receiving cryptoassets from a hard fork?

Answer

The receipt of cryptoassets from a hard fork is taxable where a person:

- has a cryptoasset business; or
- acquired the cryptoassets as part of a profit-making undertaking or scheme.
- In other cases, the receipt is not taxable.

The disposal of cryptoassets that were received from a hard fork is taxable where a person:

- has a cryptoasset business;
- disposed of the cryptoassets as part of a profit-making undertaking or scheme;
- acquired the cryptoassets for the purpose of disposing of them; or
- acquired the original cryptoassets for the purpose of disposing of them (where the person receives the new cryptoassets through an exchange).

In most cases, the disposal will be taxable.

Key terms

Blockchain is a type of distributed ledger technology, providing a digital record of transactions that is shared and maintained by users across a network.

Cryptoassets are cryptographically secured digital representations of value that can be transferred, stored or traded electronically. They use some form of distributed ledger technology such as blockchain. Cryptoassets may also commonly be referred to as cryptocurrencies, digital tokens or virtual currencies.

Cryptoasset business is a business that uses cryptoassets as part of its day-to-day activities, such as an exchange, a cryptoasset dealing business or a mining business.

Disposal includes selling cryptoassets for money, exchanging them for other cryptoassets or using them to acquire goods or services.

Hard fork is described at [1] below.

Explanation

What is a hard fork?

1. A hard fork has been described as follows:[21]

   As the rules relating to the functioning of each type of virtual currency are established by the underlying protocol that is shared by all of the users of that token, most changes to how the token functions requires a change to that protocol. These might be for example changes that would improve the speed at which transactions can be processed by changing how much information can be included in each block on the chain.

[21] OECD *Taxing Virtual Currencies, an Overview of Tax Treatments and Emerging Tax Policy Issues* (OECD, Paris, 2020) at 1.2.2. This item deals with the income tax consequences of receiving new cryptoassets from a hard fork. Forks that do not result in a new cryptoasset being received (for example, a soft fork) are not relevant for the purposes of this item.

These changes are known as forks in the chain and require users to update the protocol software they are running. In order to implement a fork, a majority of users running the protocol must agree to the change. There are two main types of fork:

- **A hard fork** (sometimes also referred to as a "chain split") changes the protocol code to create a new version of the blockchain alongside the old version, thus creating a new token which operates under the rules of the amended protocol while the original token continues to operate under the existing protocol. One example of this was the July 2017 hard fork of Bitcoin that saw the creation of the Bitcoin Cash token alongside Bitcoin...
- **A soft fork** also updates the protocol, however, it is intended to be adopted by all users on the network and thus no new coin is expected to be created (e.g. the August 2017 Segwit fork to the Bitcoin protocol).

2. A person who holds the original cryptoassets in a wallet or on an exchange that supports the hard fork at the time the fork occurs will generally have the right to an equivalent value of new cryptoassets on the new blockchain.

Holding cryptoassets on an exchange that supports the hard fork

3. Generally, a person who holds their cryptoassets on an exchange will receive the new cryptoassets only if the exchange supports the hard fork. In that case, the person may receive the new cryptoassets by way of a credit to their account without doing anything.

Holding cryptoassets on an exchange or in a wallet that does not support the hard fork

4. Where a person holds their cryptoassets on an exchange, in a wallet that does not support the fork or in a cold wallet (that is, offline), they may not receive an entitlement to the new cryptoassets from the hard fork.
5. To be entitled to the new cryptoassets from the hard fork, the person will need to move their original cryptoassets onto an exchange or wallet that supports the hard fork before the 'snapshot date'. This may incur transaction fees or exchange fees.
6. When the original cryptoassets are held on an exchange or in a wallet that supports the hard fork prior to the snapshot, the person will generally become entitled to the cryptoassets after the snapshot has occurred.
7. Unless the person holds their cryptoassets on an exchange which supported the fork and has received a credit to their account, the person will then need to decide whether they undertake the necessary steps to get possession and control of the new cryptoassets. These steps may include the following:
   - downloading the new cryptoasset's wallet and syncing the new blockchain;
   - importing private keys; and
   - transferring cryptoassets between wallets at various stages (eg, for security reasons). Transaction fees are usually payable for such transfers.

Is the receipt of the new cryptoassets taxable?

8. When a person receives cryptoassets from a hard fork, the first question is whether that receipt is taxable. As explained below, in most cases the receipt of new cryptoassets from a hard fork is unlikely to be taxable.

Business income

9. An amount a person derives from a business is their income unless the amount is of a capital nature (s CB 1). An "amount" includes money's worth. Cryptoassets, while not money, are money's worth, so the receipt of cryptoassets could be an amount derived from a business. The question is whether the amount is derived from the current operations of the business, in the ordinary course of the business, or as an ordinary incident of the business.[22] The answer to this question depends on the nature of the business and its relationship with the cryptoassets.
10. The receipt of cryptoassets from a hard fork is likely to be in the ordinary course, or an ordinary incident, of cryptoasset businesses (such as mining or dealing businesses) but would not generally be an ordinary incident of other types of businesses. Whether receipt occurs in the ordinary course, or as an ordinary incident, of a business will depend on the type of business and the way in which it earns income. The receipt of new cryptoassets from a hard fork would be taxable if the receipt could be said to be part of the way in which the business earns its income.
11. A business that is not actively involved in cryptoassets as part of its day to day business may hold cryptoassets for various reasons. For example, it may receive cryptoassets as a payment provided for goods (a barter transaction). Where such a business receives new cryptoassets from a hard fork, the new cryptoassets are unlikely to be connected to the current

[22] *CIR v City Motor Service Ltd; CIR v Napier Motors Ltd* [1969] NZLR 1,010 (CA) and *AA Finance Ltd v CIR* (1994) 16 NZTC 11,383 (CA).

operations or be an ordinary incident of many non-cryptoasset businesses. However, this may depend on the nature of the business and the extent to which the operations of the business involve receiving payments in cryptoassets.

12. Cryptoassets received from a hard fork may form part of the trading stock of a cryptoasset business if they are held for trade or exchange in the ordinary course of the business.

Profit-making undertaking or scheme

13. An amount a person derives from a profit-making undertaking or scheme is income of the person (s CB 3). An undertaking or scheme is a series of steps directed to an end result. There needs to be a plan or purpose that is coherent and has some unity of conception. The undertaking or scheme must be carried out for the dominant purpose of making a profit.[23]

14. The receipt of cryptoassets from a hard fork could be income from a profit-making undertaking or scheme if the person has a plan directed at acquiring cryptoassets that are undergoing a hard fork, with the dominant purpose of making a profit.

Income under ordinary concepts

15. An amount will also be taxable where it is income under ordinary concepts (s CA 1(2)). Income is commonly described as something that “comes in” to a person. Factors that are relevant for deciding whether something is income include whether payments are regular or recurrent, the relationship between the payer and payee, and the purpose of the payment.[24]

16. It is unlikely that the receipt of new cryptoassets from a hard fork would occur often enough to be considered regular or recurrent. In addition, there is generally no relationship between the “payer” (the blockchain) and recipients who may do nothing other than hold the original cryptoasset at the time of the fork; nor could there be said to be a particular purpose for making a payment of the new cryptoassets to the particular recipients.

Summary

17. The receipt of new cryptoassets from a hard fork is taxable where they are received:
    - by a cryptoasset business (if received as an ordinary incident of the way in which the business earns its income); or
    - as part of a profit-making undertaking or scheme.

18. In other cases, the receipt is not taxable.

Is the disposal of the new cryptoassets taxable?

19. The second question is whether the disposal of cryptoassets received from a hard fork is taxable. As discussed below, whether a disposal is taxable will depend on the person’s circumstances. In most cases, disposals will be taxable.

Business income

20. Amounts received from disposing of cryptoassets that were received from a hard fork will be taxable income of cryptoasset businesses (such as mining and dealing businesses) as the disposal will likely be the sale of their trading stock or otherwise income from a business.

21. The disposal of cryptoassets received from a hard fork by other types of businesses is unlikely to be taxable under s CB 1 unless disposing of cryptoassets is something that occurs in the ordinary course of the business. However, the disposal may still be taxable under other provisions such as s CB 4.

Profit-making undertaking or scheme

22. There may be instances where a disposal of cryptoassets received from a hard fork are part of a profit-making undertaking or scheme, in which case the amount derived from the disposal will be income under s CB 3. This will be fact specific.

Acquired for the purpose of disposal

23. An amount derived from disposing of personal property is income if the person acquired the property for the purpose of disposing of it (s CB 4). The decision in Ruscoe clarified that cryptoassets can be property.[25]

[23] *Investment & Merchant Finance v FCT* (1970) CLR 177 (HCA); *Vuleta v CIR* [1962] NZLR 325 (SC); *Duff v CIR* (1982) 5 NZTC 61,131 (CA); and *Case S86* (1996) 17 NZTC 7,538 (TRA).

[24] See *Tennant v Smith* (1892) 3 TC 158 (HL); *CIR v Grover* (1988) 10 NZTC 5,012 (CA) and *Reid v CIR* (1985) 7 NZTC 5,176 (CA).

[25] *Ruscoe v Cryptopia Ltd (in liq)* [2020] NZHC 728; (2020) 5 NZTR 30-001.

24. For s CB 4 to apply, disposal must be the person's dominant purpose for acquiring the property.[26] The Commissioner's general position is that in most cases cryptoassets will be acquired for the dominant purpose of disposal, unless a person can provide clear and compelling evidence to show otherwise.[27]
25. Where a person passively acquires property, for example, by inheritance or gift, they generally do not have a purpose when acquiring that property. However, a person will not be regarded as a passive recipient where they have turned their mind to acquisition or provided consideration.[28]
26. A person acquires cryptoassets from a hard fork when the person has possession and control of the cryptoassets and can deal with them. This is when the person holds the private key (or otherwise has the cryptoassets credited to their account on an exchange). Accordingly, all steps and actions of the person up until that time are relevant for determining what the person's purpose was when that cryptoasset was acquired. At that time, the person generally has had to turn their mind to whether they take possession of the cryptoassets.

Situations where a person turns their mind to acquiring the cryptoassets

27. As previously stated, a person receives an entitlement to the new cryptoassets where they held the original cryptoassets on a relevant exchange or wallet that supported the hard fork at the snapshot.
28. In some cases, people will need to acquire eligible cryptoassets or transfer their cryptoassets on to a relevant wallet or exchange in order to be eligible for the hard fork. When a person has had to do this, they have turned their mind to the acquisition of the cryptoassets and will have a purpose in acquiring the cryptoassets. Section CB 4 will apply if they acquired those cryptoassets for the purpose of disposal.
29. Even where a person does not have to buy or transfer original cryptoassets (because they are already held in a supporting wallet), claiming the cryptoassets still requires a decision to be made, and several steps undertaken. Usually, a decision is involved as to whether or not to claim the cryptoassets from the hard fork. There may be issues with security, the hard fork may fail and/or the cryptoassets may have limited value.
30. Once a person has made the decision to claim the new cryptoassets, they generally:
    - download a new wallet and sync the blockchain;
    - transfer their original cryptoassets out of the original wallet to avoid any security issues (although this is not mandatory) and pay transaction fees; and
    - import their private keys into the new wallet.
31. A person turns their mind in some way to acquiring cryptoassets when they make the decision to claim the cryptoassets and undertake the above steps. As noted at [26], because a cryptoasset is acquired for tax purposes when a person has control over it, all the steps taken up to that time are relevant for determining whether they have a purpose at the time of acquisition. A purpose may be determined where the person has had to turn their mind to acquiring the cryptoassets in some way. Section CB 4 will apply to tax the disposal of the cryptoassets if they were acquired for the purpose of disposal.
32. In summary, a purpose on acquisition can be determined where a person has had to turn their mind to claim their cryptoassets. This includes situations where the person:
    - acquires original cryptoassets in order to be entitled to the new cryptoassets from the hard fork;
    - transfers their cryptoassets to a supporting exchange or wallet to ensure they are eligible (prior to the snapshot); or
    - makes a decision to claim the cryptoassets, downloads the new wallet and undertakes steps to claim the new cryptoassets.

    In these cases, s CB 4 will apply where the person's purpose in acquiring cryptoassets is to dispose of them. As stated above, all steps and actions of the person up until they have possession and control of the cryptoasset are relevant for determining the person's purpose on acquisition.

Situations where a person has not had to turn their mind to claim the cryptoassets

33. There are situations where a person may not have to specifically turn their mind to claiming the cryptoassets from a hard fork. This is where they hold the cryptoassets on an exchange that supports the fork, and the cryptoassets are credited

[26] *CIR v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA).

[27] See **https://www.ird.govt.nz/cryptoassets**.

[28] *Case F41* 74 ATC 227 (Board of Review); *FCT v Miranda* 76 ATC 4180 (NSWSC); *Tikva Investments Pty Ltd v FCT* 72 ATC 4231 (HCA).

to their account. In this event, it is still possible to attribute a purpose on acquisition of the new cryptoassets, being the purpose for which the original cryptoassets were acquired.

34. The same purpose can be attributed in this situation due to the relationship between the two blockchains - both carrying the same transactional history up to a point in time. The new blockchain and its cryptoassets are derived from the same property as the original blockchain and its cryptoassets, generally with only a change to the existing protocol (such as different block sizes) being the event triggering the hard fork. A hard fork could objectively be said to be an anticipated consequence and a normal feature of decentralised blockchains (such as Bitcoin), where users can propose protocol changes (for example, proposing a different consensus protocol, or different block sizes).[29] It is also likely that the value of the new blockchain and its cryptoassets is derived to an extent from the existing blockchain (at least at the time of the fork).

35. Accordingly, treatment under s CB 4 is similar to that for share subdivisions and demergers. That is, if the original cryptoassets were acquired for the purpose of disposal, the new cryptoassets will also be acquired for the same purpose. In that event, disposals will be taxable under s CB 4.

Summary

36. The disposal of cryptoassets that were received from a hard fork is likely to be taxable in most cases, although this will depend on the circumstances. The disposal will be taxable where the person:
    - has a cryptoasset business;
    - disposes of the cryptoassets as part of a profit making undertaking or scheme; or
    - acquired the cryptoassets (including in some cases the original cryptoassets) for the purpose of disposing of them.

Are any deductions available?

37. The third question is whether any deductions are available if any amounts are taxable. As discussed below, generally no deductions are available as no expenditure is usually incurred in acquiring cryptoassets from a hard fork. However, deductions will be available where cryptoassets are taxed on receipt and also on disposal.

The cost of the cryptoassets

38. Where the receipt or disposal of cryptoassets is taxable, deductions for expenditure incurred may be available (s DA 1 or s DB 23). However, other than transaction fees, there is generally no expenditure incurred when a person receives cryptoassets from a hard fork. Therefore, no deduction (other than for transaction fees) will generally be available.

39. However, where a person is taxed on both the receipt and disposal of a cryptoasset then a deduction for the cost of the cryptoasset is available at the time of disposal (ss DB 23 and EA 2). Where a person is taxed on receipt and disposal, the cost of acquiring that cryptoasset can take into account the value of the cryptoasset at the time of receipt (which the person paid tax on). Allowing a cost for this amount ensures the person is not effectively taxed twice on the initial value of the cryptoasset.[30]

Trading stock rules

40. Cryptoassets received from a hard fork that form trading stock of a business may also be taxable on receipt and on disposal. For the same reasons as above, a person who holds trading stock that is taxable both on receipt and on disposal may claim a deduction for cost relating to the value on receipt (which the person paid tax on). This deduction may be claimed in the year the receipt is returned as income. The person must then value the trading stock at the end of each income year under the trading stock rules (in Part E of the Act).

41. Standard valuation methods apply to the valuation of trading stock. There are no special rules for cryptoassets, so a person may use whatever method is available to them. However, the value of any trading stock that is an excepted financial arrangement must be valued at cost.[31] If a person uses a different method, they must satisfy all the requirements of the method. There may be difficulties in satisfying methods that refer to a value (or an amount that would be expected to be received) due to the volatility of cryptoasset prices.

[29] This is shown by the number of Bitcoin hard forks that have occurred to date, for example, Bitcoin XT in 2014, Bitcoin Classic and Bitcoin Unlimited in 2016, and Bitcoin Cash, Bitcoin Gold and Bitcoin Diamond in 2017, amongst others.

[30] This is considered to be consistent with comments made in *Tasman Forestry Ltd v CIR* (1999) 19 NZTC 15,147 (CA), *Sharkey v Wernher* [1956] AC 58 (HL); *Halliwell v CIR* (1991) 13 NZTC 8,197 (HC); and *Rangatira Ltd v CIR* (1996) 17 NZTC 12,727 (PC).

[31] Cryptoassets are proposed to be included as excepted financial arrangements (with retrospective effect), and so cost appears the most appropriate valuation method. Cost will be the only appropriate method once this legislative change is enacted.

Examples

Example 1: Ethel received Bitcoin Cash

Ethel acquired USD1,000 of Bitcoin in June 2017 so she could use it to pay for things over the internet. She found out that Bitcoin would undergo a hard fork in August 2017 and "Bitcoin Cash" (a new cryptoasset) would be created.

Ethel decided she wanted to claim Bitcoin Cash as it could be a faster way to pay for internet transactions. Ethel transferred her Bitcoin into a wallet that supported the hard fork. The hard fork occurred in August 2017 and Ethel downloaded the new wallet and undertook the necessary steps to acquire the Bitcoin Cash.

In 2019, Ethel cashed up half of her Bitcoin and Bitcoin Cash as she was not using it for as many internet transactions as she hoped. These disposals are taxable under s CB 4 as Ethel acquired both her Bitcoin and her Bitcoin Cash for the dominant purpose of disposing of it.

Ethel's remaining Bitcoin Cash hard forked again a year later, and Bitcoin SV was created. However, Ethel decided not to claim Bitcoin SV as she didn't think it was worth it. As she did not acquire it, there are no tax consequences.

Example 2: Beth holds Bitcoin on an exchange

Beth acquired NZD500 of Bitcoin in April 2017 and kept it on an exchange along with various other cryptoassets she was using for small trades. The exchange announced it was supporting the Bitcoin Cash hard fork and Beth did not have to do anything in order to receive the equivalent amount of Bitcoin Cash credited to her account.

Beth started trading the Bitcoin Cash along with her other cryptoassets. Beth acquired the Bitcoin Cash for the same purpose as she acquired the Bitcoin – to dispose of it. Every time Beth makes a trade of Bitcoin Cash, she must pay tax on that trade under s CB 4.

References

Legislative references

Income Tax Act 2007 – ss CA 1(2), CB 1, CB 3, CB 4, DA 1, DB 23, EA 2

Case references

AA Finance Ltd v CIR (1994) 16 NZTC 11,383 (CA)

Case F41 74 ATC 227 (Board of Review)

Case S86 (1996) 17 NZTC 7,538 (TRA)

CIR v City Motor Service Ltd; CIR v Napier Motors Ltd [1969] NZLR 1,010 (CA)

CIR v Grover (1988) 10 NZTC 5,012 (CA)

CIR v National Distributors Ltd (1989) 11 NZTC 6,346 (CA)

Duff v CIR (1982) 5 NZTC 61,131 (CA)

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Vuleta v CIR [1962] NZLR 325 (SC)

Other references

Inland Revenue, Cryptoassets (**www.ird.govt.nz/cryptoassets**)

OECD (2020) *Taxing Virtual Currencies, an Overview of Tax Treatments and Emerging Tax Policy Issues* (OECD, Paris).

QB 21/08: GST – How do the compulsory zero-rating of land rules apply to transactions involving commercial leases?

Question

How do the compulsory zero-rating of land rules (CZR rules) apply to transactions involving commercial leases?

Answer

Generally, the CZR rules will not apply to supplies made under commercial leases. However, some supplies made under or in relation to commercial leases are subject to the CZR rules. These supplies are:

(a) a supply made under a commercial lease where the consideration includes a non-regular payment (lump-sum payment) of more than 25% of the term consideration, and certain other supplies made under the same lease;

(b) the assignment or surrender of a commercial lease;

(c) the reverse surrender of a commercial lease (where a lessee pays a lessor to take back a lease); and

(d) a supply of lease procurement services; that is, a supply made under an arrangement that involves the lessee's surrender of a commercial lease and the grant of a new commercial lease by the lessor to another person.

Explanation

1. All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.
2. This Question We've Been Asked (QWBA) deals with the application of the CZR rules to commercial lease transactions between GST-registered persons where the leased premises are used in a taxable activity.
3. A commercial lease is a lease that is not a lease of a dwelling (s 2(1), definition of "land", para (b)(ii)).

Overview of the CZR rules

4. Usually, a registered person making a supply in the course or furtherance of their taxable activity charges GST at the prevailing standard rate on the supply (s 8(1)). In some situations, zero-rating rules apply. These rules require the supplier to charge GST at the rate of 0% on the supply (s 11). Consequently, the recipient cannot claim an input tax deduction for that supply.
5. The core provision of the CZR rules is s 11(1)(mb). Under ss 8 and 11(1)(mb), a vendor must zero-rate a supply if:
   - the supply is a supply of goods that wholly or partly consists of land;
   - the vendor is GST registered (or will be GST registered or will be treated as GST registered) at the time of settlement;
   - the supply is being made by the vendor in the course or furtherance of their taxable activity;
   - the purchaser is a GST-registered purchaser (or will be GST registered or treated as GST registered) at the time of settlement;
   - the purchaser acquires the goods (including the land) with the intention of using them (in whole or part) for making taxable supplies; and
   - none of the land included in the supply is intended to be used as the purchaser's principal place of residence or the principal place of residence of a relative of the purchaser.
6. If a supply is not made in the course or furtherance of a GST-registered vendor's taxable activity (for example, when a GST-registered vendor sells their private home), the supply is generally outside the GST rules.
7. If a leasehold interest in land is supplied as part of a larger supply (and the requirements of s 11(1)(mb) are met) the whole supply is zero-rated. The supply may also be zero-rated under s 11(1)(m) (transfer of a going concern), if the requirements of that section are met.
8. For a more detailed overview of the CZR rules, see "IS 17/08: Goods and Services Tax – compulsory zero-rating of land rules (general application)", *Tax Information Bulletin* Vol 29, No 10 (November 2017): 17.

Section 11(8D)

9. Most supplies made under commercial leases are excluded from the CZR rules by s 11(8D)(b). However, commercial leases with characteristics making them substitutable for land sales and transactions involving the assignment, surrender or procurement of commercial leases may be subject to the CZR rules if certain conditions, including the conditions in s 11(1)(mb), are met (s 11(8D)(a), (ab) and (c)).
10. Section 11(8D) applies to "interests in land" and agreements for the supply of "interests in land". A lease is an interest in land.
11. The following elements of s 11(8D) are considered in more detail below:
    - regular lease payments and non-regular lease payments that are 25% or less of the term consideration are generally excluded from the CZR rules under s 11(8D)(b) (see [12]);
    - assignments and surrenders of leases are subject to the CZR rules under s 11(8D)(a)) (see [24]);
    - reverse surrenders (where a landlord receives a payment for the surrender of a right to receive lease payments) are subject to the CZR rules under s 11(8D)(ab) (see [27]); and
    - lease procurement services are subject to the CZR rules under s 11(8D)(c) (see [29]).

Non-regular payments of more than 25% of the term consideration

12. The CZR rules treat certain supplies of land as zero-rated rather than taxable. The rules were introduced to help combat phoenix fraud where a supplier of land absconds or is wound up without returning GST, but the purchaser (generally a related party) is still entitled to an input tax deduction. Most transactions that are, economically, a supply of commercial land are captured by the rules. An exception is a commercial lease, which, to reduce compliance costs, is excluded unless it possesses the less usual feature of irregular large lump-sum payments, which could suggest it could be substitutable for a transfer of land. See "*Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Bill* (Commentary on the Bill, May 2016)": 75.
13. The effect of s 11(8D)(b) is that the CZR rules generally will **not** apply to:
    - regular payments made under a lease; and
    - lump-sum payments that are 25% or less of the term consideration (see [17] for the meaning of "term consideration").
14. Specifically, a supply made under a lease agreement that meets the requirements of s 11(1)(mb) is not subject to the CZR rules, if all of the following three elements are met (see Example 1):
    - When the lease agreement is entered into, each lump-sum payment is expected to be 25% or less of the term consideration.
    - The payment to which the supply relates, if it is a lump-sum payment, is in fact 25% or less of the term consideration.
    - Each lump-sum payment that is paid or payable before the payment to which the supply relates is 25% or less of the term consideration.
15. In the nine examples below, it is assumed that the lessee or purchaser (as the case may be) meets the requirements of s 11(1)(mb)(i) (ie, they are a registered person who acquires the goods with the intention of using them for making taxable supplies) and that the supply meets the requirements of s 11(1)(mb)(ii) (ie, it 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 s 2A(1)(c)).

Example 1: Lease payments excluded from the CZR rules

Alex owns a property on a busy street in a large city. She is registered for GST. On 1 September 2019, she enters into an agreement to lease the property to a retail company for a period of five years, with a right of renewal for a further five years.

Under the terms of the lease, the company is required to pay monthly rent of $6,250 ($75,000 per year), plus additional non-regular payments on 30 April 2020 and 30 April 2021 of $50,000 each.

The term consideration under the agreement is $475,000 (regular lease payments of $75,000 × 5 years, plus the non-regular payments of $100,000). The payment of $50,000 on 30 April 2020 is less than 25% of the term consideration, so s 11(8D)(b) excludes the 30 April 2020 supply under the lease agreement from zero-rating under s 11(1)(mb).

The further payment of $50,000 on 30 April 2021 is less than 25% of the term consideration, and the previous $50,000 payment was also less than 25% of the term consideration. Therefore, s 11(8D)(b) excludes the 30 April 2021 supply under the lease agreement from zero-rating under s 11(1)(mb).

16. The following elements of s 11(8D)(b) are considered in more detail below:
    - term consideration (see [17]);
    - regular, periodic lease payments not subject to the CZR rules (from [18]); and
    - lump-sum payments subject to the CZR rules (from [21]).

Term consideration

17. For commercial leases, the term consideration is the total amount of consideration calculated under the lease agreement during a period that is the longer of one year and the shortest possible fixed term under the lease agreement; that is not including any renewal period (s 11(8D)(b)(iv)). See Example 2.

Example 2: Term consideration

As Alex (from Example 1) entered into a five-year lease, with an option to extend for a further five years, the term consideration is the sum of the monthly rental payments received during the first five-year period plus any lump-sum payments Alex received during that time.

If the parties had entered into a monthly lease with no fixed term, then the term consideration would be the total payments Alex received in the first year.

Regular, periodic lease payments not generally subject to the CZR rules

18. Section 11(8D)(b) applies where payments that are not "regular payments" are made under a lease.
19. The term regular payment is not defined in the Act. The *Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York, 2011) contains the following definition:

    Regular adj … **2**. *Recurring at short uniform intervals… done or happening frequently.*

20. In the context of leases, a regular payment is generally a payment of rent. Therefore, where an ordinary payment of rent that is more than 25% of the term consideration is made, the CZR rules will not apply, provided that no lump-sum payments are anticipated, when the lease is entered into, to be more than 25% of the term consideration, and provided each lump-sum payment paid or payable before the regular payment has actually been 25% or less of the term consideration. See Example 3.

Example 3: Regular, periodic lease payments

Instead of a five-year lease, Alex (from Example 1) enters into a one-year lease with quarterly payments but without any lump-sum payments. The quarterly payments vary slightly as they are based on the annual rent of $75,000 pro-rated for the number of days in the quarter.

The payments are not zero-rated, even though some represent more than 25% of the term consideration.

Lump-sum payments (and certain regular payments) subject to the CZR rules

21. If a lump-sum payment is payable under a lease agreement and is anticipated, when the lease agreement is entered into, to be more than 25% of the term consideration, the CZR rules apply to all payments made under the lease including regular payments. Section 11(8D)(b) prevents taxpayers circumventing the CZR rules by making large lump-sum payments under lease agreements.

22. Further, if a lump-sum payment of more than 25% of the term consideration is in fact made but was not anticipated when the lease agreement was entered into, all lease payments including regular payments will be subject to the CZR rules from that payment onwards. There is no requirement to retrospectively zero-rate payments made earlier. See Example 4.

Example 4: Lump-sum payments

Following from Example 1, Alex's property is on the main street of a smaller city. The terms of the lease remain the same as Example 1 except the monthly rent is $2,250 and only one lump-sum payment, anticipated, when the agreement is entered into, to be $30,000, but in fact, $50,000, is made on 30 April 2020.

The term consideration as anticipated when the agreement is entered into would be $165,000 (regular lease payments of $27,000 x 5 years, plus the non-regular payment of $30,000). The anticipated payment of $30,000 would be less than 25% of the anticipated term consideration.

The actual term consideration under the agreement would be $185,000 (regular lease payments of $27,000 × 5 years, plus the non-regular payment of $50,000).

The non-regular payment of $50,000 is more than 25% of the term consideration, so s 11(8D)(b) does not exclude the supply under the lease agreement from zero-rating under s 11(1)(mb).

If the requirements of s 11(1)(mb) are met, the lump-sum payment of $50,000 and all subsequent payments must be zero-rated.

Lease granted on business asset sale

23. A vendor may choose to grant a lease or sub-lease of the business premises to a purchaser of the business instead of selling the business premises or assigning their lease. This type of transaction is not zero-rated under s 11(8D)(b), even if the lease payments are zero-rated under s 11(8D)(b). This is because the business assets are not transferred "under an agreement providing for periodic payments for supplies of the interest in land" as required by s 11(8D)(b). The transaction may be zero-rated as a transfer of a going concern under s 11(1)(m) if the requirements of that section are met on the facts.

Assignments and surrenders

24. An assignment or surrender of a lease is subject to the CZR rules if it meets the requirements of s 11(1)(mb) (s 11(8D)(a)). See Example 5.

Example 5: Lease assignment

JM Ltd is carrying on a taxable activity and is registered for GST. JM Ltd's business premises are leased. JM Ltd is moving to larger business premises and enters into an agreement to assign its interest as lessee under the existing lease to a third party.

The lease assignment is zero-rated in accordance with s 11(1)(mb) and (8D)(a). JM Ltd has an interest in land, and it is assigning that interest in land to the third party.

25. Where a lease is assigned together with other business assets both the lease assignment and other business assets will be zero-rated, assuming the assignment of the lease and the sale of the other business assets are part of a single composite supply. This will be the case even if no consideration is allocated to the lease assignment. See Example 6.

26. For a detailed discussion of whether goods and services are supplied as elements of a single composite supply or as multiple supplies, see "IS 18/04: Goods and services tax – single supply or multiple supplies", *Tax Information Bulletin* Vol 30, No 10 (November 2018): 5.

Example 6: Lease assignment on business asset sale

JM Ltd (from Example 5) enters into an agreement to sell its business (including the lease of the new business premises) to a third party. The agreement for sale and purchase of the business provides that the lease will be assigned but no consideration is allocated to the lease assignment in the agreement.

The sale of business assets (including the lease assignment) is zero-rated in accordance with s 11(1)(mb) and (8D)(a) (assuming the lease and other business assets are supplied as a single composite supply). JM Ltd has an interest in land, and it is assigning that interest in land to the third party.

Reverse surrenders

27. A supply that is a surrender of a right to a payment under an agreement for the supply of an interest in land is subject to the CZR rules if it meets the requirements of s 11(1)(mb) (s 11(8D)(ab)).
28. Section 11(8D)(ab) is intended to catch "reverse surrender" payments a tenant makes to a landlord (where the landlord surrenders their contractual right to receive payment under the lease).

Arrangements for the surrender of a lease and grant of a new lease to another person

29. Section 11(8D)(c) deals with situations that arise when a supply is made by a person who is a lessee under a lease agreement. If all the following three elements are satisfied then, despite s 11(8D)(b), s 11(1)(mb) will apply to zero-rate the supply:
    - The supply is made to a person who is not the lessor. The lessor in this context is the person who is supplying an interest in land under the lease agreement to the lessee.
    - The supply is made under an arrangement that involves the:
        - lessee's surrender of the interest in land to the lessor; and
        - supply by the lessor of the interest in land under another lease agreement to a person other than the lessee.
    - The supplies of the interests in land under the lease agreements meet the requirements set out in s 11(1)(mb).
30. Section 11(8D)(c) is likely to be relevant in the context of a business sale, where a lease is novated or a new lease is otherwise procured for the purchaser. See Example 7.

Example 7: Lease procurement

Following from Example 6, JM Ltd is carrying on a new taxable activity and is registered for GST. JM's business premises are leased but JM's lease cannot be assigned.

JM Ltd enters into an agreement to sell its business assets to a purchaser. During negotiation of the sale agreement for the business, it is agreed that JM Ltd will use all reasonable endeavours to procure that the landlord will enter into a new lease agreement over the premises with the purchaser. The surrender of the existing lease and the grant of the new lease are closing actions in the agreement for sale and purchase.

It is considered that the business asset sale agreement, the surrender, and the grant of the new lease will together constitute an arrangement for these purposes (*CIR v Europa Oil (NZ) Ltd* [1971] NZLR 641 (PC)).

The sale of the business is zero-rated in accordance with s 11(1)(mb) and (8D)(c) (assuming the lease procurement services and business assets are supplied as a single composite supply). JM Ltd has an interest in land, and it is surrendering that interest in land so the landlord can enter into a new lease with the purchaser.

31. Section 11(8D)(c) may also apply to lease procurement services in the context of a business asset sale where a lease that has expired continues on an implied term under s 210 of the Property Law Act 2007 (PLA) and is surrendered (with a new lease being granted by the vendor's lessor to the purchaser) on a business sale. See Example 8.
32. Note s 11(8D)(c) applies if the supplies under the lease agreements are supplies of "interests in land" (s 11(8D)(c)(i)-(iii)).
33. A lease continuing on an implied term under s 210(1)(b) of the PLA is a "statutory tenancy" and a "short-term lease" (s 207 PLA). A lessee who occupies land under a "short-term lease" has a legal interest in the land (s 209(1) PLA). However this is subject to the Land Transfer Act 2017 (s 209(2) PLA). The lessee's legal interest in the short-term lease can be defeated in the same way as an equitable interest by the registration without fraud of an adverse interest (see Hinde, McMorland & Sim, *Land Law in New Zealand* (LexisNexis NZ Limited, online version, accessed 14 June 2021) at [11.021]).

Example 8: Lease continuing on implied term

Following from Example 7, JM Ltd is carrying on the new taxable activity but instead of its lease being unable to be assigned, the term of its lease of the premises has expired. The lease continues on an implied term under s 210 of the Property Law Act 2007.

JM Ltd enters into an agreement to sell its business assets to a purchaser. During negotiation of the sale agreement for the business, it is agreed that JM Ltd will surrender its lease and the landlord will enter into a new lease agreement over the premises with the purchaser. The surrender of the existing lease and the grant of the new lease are closing actions in the agreement for sale and purchase. The lessee's legal interest in land has not been defeated by the registration without fraud of an adverse interest.

The sale of the business is zero-rated in accordance with s 11(1)(mb) and (8D)(c) (assuming the lease procurement services and business assets are supplied as a single composite supply). JM Ltd has an interest in land, and it is surrendering that interest in land so the landlord can enter into a new lease with the purchaser.

34. Section 11(8D)(c) may also apply to lease procurement services and business assets a vendor supplies as a single composite supply on the sale of a business where a lease is cancelled under s 245 of the Property Law Act 2007 because the tenant has fallen into arrears and the vendor's landlord grants a new lease to the purchaser of the business assets. See Example 9.

Example 9: Lease cancellation

Following from Examples 7 and 8, JM Ltd is carrying on the new taxable activity but has instead been experiencing financial difficulties. It enters into an agreement to sell its business assets to MC Ltd.

The premises are an important element of the business. However, due to JM Ltd's financial difficulties, it has fallen into arrears in payment of rent to its landlord. The landlord has served a notice to cancel the lease of the premises in accordance with s 245 of the Property Law Act 2007.

As the lease is being cancelled in accordance with s 245 of the Property Law Act 2007, it cannot be assigned to MC Ltd. During negotiations of the sale agreement for the business, it is agreed that MC Ltd will pay an amount to the landlord and the landlord will enter into a new lease agreement with MC Ltd. The grant of the new lease is a closing action in the sale agreement.

The supply will be zero-rated in accordance with s 11(1)(mb) and (8D)(c) (assuming the lease procurement services and business assets are supplied as a single composite supply).

35. This clarification in respect of lease cancellations was made by s 184 of the Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Act 2021, and applies to supplies made by a person on or after 30 June 2014. Savings provisions apply to supplies for which a contrary tax position was taken before 30 March 2021 (the date of Royal Assent of the above act).

References

Legislative references

Goods and Services Tax Act 1985, ss 2(1) ("land"), 8(1), 11

Property Law Act 2007, ss 207, 209, 210, 245

Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Act 2021, s 184.

Other references

Concise Oxford English Dictionary (12th ed, Oxford University Press, New York, 2011).

"IS 17/08: Goods and services tax – compulsory zero-rating of land rules (general application)", *Tax Information Bulletin* Vol 29, No 10 (November 2017): 17. **https://www.taxtechnical.ird.govt.nz/tib/volume-29---2017/tib-vol29-no10**

"IS 18/04: Goods and services tax – single supply or multiple supplies", *Tax Information Bulletin* Vol 30, No 10 (November 2018): 5. **https://www.taxtechnical.ird.govt.nz/tib/volume-30---2018/tib-vol30-no10**

"*Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Bill* (Commentary on the Bill, May 2016)": 75.

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.

DEP107: General Tax Depreciation Rates for brake test rollers

Note to Determination DEP107:

The Commissioner has been asked to consider what depreciation rate should apply for brake test rollers that, as the name implies, are used for testing the brakes of motor vehicles. Brake test rollers are typically used by vehicle testing stations that perform testing for the Waka Kotahi NZ Transport Agency (NZTA) Warrant of Fitness (which applies to cars and light vehicles) and Certificate of Fitness (which applies to trucks, taxis and heavy vehicles/trailers etc.). Large service workshops may also have them to ensure that their clients vehicle brakes will meet these NZTA standards, even if they don't certify them. Both car and truck brake test rollers are similar in nature, so are grouped as a single asset class of "Brake test rollers" for the purpose of this general depreciation rate determination.

Brake test rollers are used in the following way. The vehicle to be tested is driven on to brake test rollers which are set in the garage floor. The brake test rollers are rotated slowly, turned by an electric motor. The brakes resistance is measured by load sensors attached to the motor. This information is then sent through analogue or digital gauges to be recorded using software/ digital controls.

Other types of brake test equipment

Other types of brake testing equipment, such as "plate" brake testers and decelerometers, are not covered by this general depreciation determination, as they are either portable or hand-held (not permanently fixed into the floor like brake test rollers).

Determination DEP107: Tax Depreciation Rates General Determination Number 107

This determination may be cited as "Determination DEP107 Tax Depreciation Rates General Determination Number DEP107: Brake test rollers available for use in the ordinary course of business.

1 Application

This determination applies to taxpayers who own items of depreciable property of the kind listed in the tables below:

This determination applies for the 2020/21 and subsequent income years.

2 Determination

Pursuant to section 91AAF of the Tax Administration Act 1994, the general determination applies to the kind of items of depreciable property listed in the table below by:

- Adding into the "Engineering (including automotive)" industry category, the new asset class, estimated useful life, and general diminishing value and straight-line depreciation rates listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
Brake test rollers	12.5	16	10.5

3 Interpretation

In this determination, unless the context otherwise requires, words and terms have the same meaning as in the Income Tax Act 2007 and the Tax Administration Act 1994.

REGULAR CONTRIBUTORS TO THE TIB

Tax Counsel Office

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.

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