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

Your opportunity to comment

Ref	Draft type	Title	Comment deadline
PUB00401	Determination	Foreign exchange rates	11 October 2021

IN SUMMARY

New legislation

Order in Council

LI 2021/222 - COVID-19 Resurgence Support Payments Scheme (August 2021) Order 2021 2

This Order activated the COVID-19 Resurgence Support Payments Scheme. This Order came into force on 24 August 2021.

LI 2021/238 - COVID-19 Resurgence Support Payments Scheme (August 2021) Amendment Order 2021 3

This Order amends the eligibility criteria of the COVID-19 Resurgence Support Payments Scheme (August 2021) Order 2021. This Order came into force on 9 September 2021.

LI 2021/234 - Tax Administration (COVID-19 Response Variations) Order 2021 3

This order extends the application of section 6I Tax Administration Act 1994 until September 2022. This Order came into force on 30 September 2021

This section gives the Commissioner of Inland Revenue administrative flexibility to provide relief for taxpayers adversely impacted by COVID-19.

Operational statement

OS 21/03: Excusing estates from filing income tax returns 5

This operational statement sets out a change in the Commissioner's approach to applying the income tax return filing exemption in s 43B of the Tax Administration Act 1994 to estates.

Interpretation statements

IS 21/04: Deductions for businesses disrupted by the COVID pandemic 8

This interpretation statement considers whether a business can claim an income tax deduction for expenditure or loss incurred where the business has downscaled or stopped operating because of the COVID-19 pandemic. It also briefly considers the GST implications of these events.

IS 21/07: GST - Definition of a resident 24

This interpretation statement provides guidance on how to determine whether a person is a resident for GST purposes.

Determinations

EE003: Payments provided to employees that work from home; Employee use of telecommunications tools and usage plans in their employment 35

This determination deals with the additional expenditure that employees may face when they work from home and/or use their personal telecommunications tools and usage plans in their employment. It sets out the extent to which a payment made by an employer to an employee is able to be treated as exempt income to the employee.

Determination FDR 2021/03: A type of attributing interest in a foreign investment fund for which a person may not use the fair dividend rate method 40

Any investment by a New Zealand resident investor in the NZD class units of the Daintree Core Income Trust, to which none of the exemptions in section EX 29 to 43 of the Income Tax Act 2007 apply, is a type of attributing interest for which the investor may not use the fair dividend rate method to calculate foreign investment fund income from the interest

Questions we've been asked

QB 21/09: How to determine the cost price of bloodstock 42

This question we've been asked outlines how to determine the cost price of bloodstock. It is relevant to a person who has a bloodstock breeding business.

QB 21/10: If I run a hotel, motel or boarding house and live on site, what expenditure can I claim? 47

This question we've been asked provides guidance on the deductibility of expenses commonly incurred by hotel, motel and boarding house proprietors who live on site, particularly where the expenses have both a business and private character.

NEW LEGISLATION

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

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

The COVID-19 Resurgence Support Payments Scheme (August 2021) Order 2021 came into force on 24 August 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 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 seven-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 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.

At 11.59pm on 17 August 2021, COVID-19 alert levels for New Zealand were raised to level 4. This escalation lasted seven-days, triggering the activation of the Scheme. The COVID-19 Resurgence Support Payments Scheme (August 2021) Order 2021 (the Order) came into force on 24 August 2021 activating the Scheme. The Scheme will remain in activation until at least the first working day one month after all areas of New Zealand return to COVID-19 alert level 1.

Class of persons covered

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

An eligible person must be one of the following:

- a self-employed individual
- a body corporate or 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.

Eligibility

The RSP is designed to support businesses which have experienced a 30% drop in revenue compared with typical revenue in an earlier period. The Order contains a provision that for this purpose, a business may use a consecutive seven-day period that reflects the typical revenue for that business in the six weeks prior to the escalation in alert levels with a consecutive seven-day

period 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 needs to be satisfied across the group as a whole. 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 (**ird.govt.nz/covid-19/business-and-organisations/resurgence-support-payment/eligibility**).

To qualify for a grant under the Order, the seven-day period used to demonstrate a decline in revenue must be a seven consecutive day period between 17 August 2021 to the day before the date all areas of New Zealand return to COVID-19 alert level 1 (both dates inclusive).

Further eligibility requirements 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 **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
- four times the amount by which the eligible person's revenue has declined.

Applications

RSP applications in response to the COVID-19 alert level escalation opened on 24 August 2021 and may be submitted via myIR until the first working day that is at least one month after all areas of New Zealand return to COVID-19 alert level 1.

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 **ird.govt.nz/covid-19/business-and-organisations/resurgence-support-payment/apply**

COVID-19 Resurgence Support Payments Scheme (August 2021) Amendment Order 2021

The COVID-19 Resurgence Support Payments Scheme (August 2021) Amendment Order 2021 came into force on 9 September 2021. This Order amends the eligibility criteria of the COVID-19 Resurgence Support Payments Scheme (August 2021) Order 2021.

The above TIB item on the COVID-19 Resurgence Support Payments Scheme (August 2021) Order 2021.

Background

The COVID-19 Resurgence Support Payments Scheme (August 2021) Order 2021 (the principal order) determines the class of persons who can apply for COVID-19 Resurgence Support Payments Scheme (the Scheme), the eligibility criteria and the payment amount.

The eligibility criteria includes a requirement for applicants to have been in business or operation for at least six months before the 17 August 2021 COVID-19 alert level escalation.

Amendment to eligibility criteria

The amending Order (COVID-19 Resurgence Support Payments Scheme (August 2021) Amendment Order 2021) reduces the time required for a business to have been in operation before they are eligible for the Scheme, from at least six months to at least one month.

This change ensures that the Scheme better supports newly established businesses. Applicants are still required to meet the other eligibility requirements under the Scheme, such as demonstrating a 30% revenue loss.

Applications

Applications under the new requirements opened on 9 September 2021 and may be submitted via myIR.

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

Inland Revenue is contacting any businesses who were declined for not meeting the six-month test to advise them of the new criteria and invite them to reapply under the new settings.

Tax Administration (COVID-19 Response Variations) Order 2021

The Tax Administration (COVID-19 Response Variations) Order 2021 came into force on 30 September 2021. The Order extends the application of section 6I of the Tax Administration Act 1994 from 1 October 2021 until 30 September 2022.

Background

In 2020, greater administrative flexibility was granted to the Commissioner in section 6I of the Tax Administration Act 1994 as part of the response to COVID-19 (see TIB vol 32 No 7 August 2020). The discretion allows the Commissioner to vary time-related requirements (such as timelines, due dates, deadlines, and time periods), procedural or administrative requirements when taxpayers are likely to be impacted by COVID-19, and compliance with current requirements is impossible, unreasonable, or impractical.

The discretionary power allows the Commissioner to issue variations to provide flexibility for taxpayers to comply with their tax obligations under the Inland Revenue Acts where they have been affected by the impacts of COVID-19. Where taxpayers comply with a variation, they are treated as if they complied with the requirement set out in legislation.

The measure was originally limited in application to an 18-month period ending 30 September 2021. However, section 6H of the Tax Administration Act 1994 provides that the measure may be extended upon the recommendation of the Minister of Revenue if it is reasonably necessary in the circumstances because of the continuing impact of COVID-19 related measures or circumstances. This Order in Council extends the Commissioner's COVID-19 administrative flexibility measure to 30 September 2022 which will enable the Commissioner to act quickly in the event taxpayers are further impacted by COVID-19.

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 21/03: Excusing estates from filing income tax returns

Introduction

Section 43B allows trustees of non-active trusts to be excused from the obligation to file income tax returns if the trusts meet certain requirements.

With some exceptions, the Commissioner's general approach has been that s 43B only applies to non-active trusts. It does not apply to deceased estates that similarly derive no income. This is on the basis that "estates" are something different to "trusts".

The Commissioner has now modified her position to accept that there can be occasions during the administration of an estate where the estate property is held on trust and the s 43B exemption can apply.

This Statement sets out the broad approach that the Commissioner is taking to determining whether an estate's administration has got to that point.

The requirement to file income tax returns

1. For income derived by a deceased person until the date of death, executors and administrators must meet whatever filing and income tax obligations the deceased would have had if they had remained alive (s 43). If the deceased only had "reportable income" (types of income where tax has been withheld at source by the payer, such as employment and investment income), these obligations can be met through the pre-populated account process in subpart 3B ("auto-calc").
2. Executors and administrators must also obtain a separate IRD number for the estate and make returns for income derived in the years following death.
3. The prescribed return form to be used for income derived after death is the same income tax return as prescribed for trustees (the IR 6 return). However, this is for administrative convenience rather than because an estate is a trust.

Being excused from filing a return under s 43B

4. Under s 43B, a "trustee of a trust" can apply to be excused from the obligation to file income tax returns if they meet the specified requirements. These requirements concern being a "complying trust" as described in s HC 10 of the Income Tax Act 2007, making a declaration to the Commissioner as to various matters (the IR 633 form has been prescribed for this - more information can be obtained at **ird.govt.nz/roles/trusts-and-estates/trusts-and-tax-residency**) and also not having any income or deductible expenditure for the year, ie they are "non-active".
5. The reference to "trustee of a trust" means that any exemption from filing is limited to situations where there is a "trust".
6. While "trustee" is a defined term and can include an executor or administrator, "trust" is not a defined term in tax legislation and has the meaning it has in general law. That meaning is broad. However, a trust does not automatically arise in the administration of every estate. In general law, the position is that executors hold the property in the estate "in right of the deceased" and not in trust. A trust can, and often does, arise before an estate is fully administered but administration of the estate needs to have reached the stage of the property being held by someone with the special duties of a trustee.
7. Therefore, at some point in the administration of an estate a trust can arise, and that trust may qualify under s 43B. However, this does raise the question of how to determine when administration of an estate has got to the point that property that until then was part of the estate is now held on a trust.

When will a trust arise in the administration of a deceased estate?

8. Executors and administrators of estates have duties to collect the deceased's property and to use it to meet any expenses, debts and legacies and to distribute what is left according to the directions in a will or the law of intestacy. A trust will only arise when executors and administrators have completed their duties to the point that they stand ready to "distribute" the remaining property (in technical terms, this is referred to as "assent"). The fact the estate administration has reached this point can be evidenced in various ways, depending on the particular circumstances. For example, it might be explicit in or able to be inferred from a letter to a trust beneficiary from an executor. Or it might be clear from their actions.
9. Interpretation Statement IS 18/01 *Taxation of trusts* has further discussion (from [9.25]) on taxation in the context of deceased estates.
10. At the time of assent, the distribution may be to separate trustees specified in a will (so it will usually be straightforward to identify that a trust has arisen). However, it is common for a will to specify that the executors are also to be the trustees so there is a distribution only in the sense that the executors cease to hold the property in their capacity as executors and begin holding the property in a separate capacity as trustees.
11. A trust provided for in a will is known as a testamentary trust. Testamentary trusts are general law trusts. It follows that a testamentary trust, once it arises, is a "trust" for the purposes of s 43B.
12. Once administration of an estate by executors gets to the point that the assets in the estate are ready for distribution and are held by trustees of a testamentary trust for beneficiaries and the assets do not generate any income, s 43B may apply. The testamentary trust may be expressly provided for in the will or it may be implied.
13. A common situation is where the only significant property in the estate is a house, and a family member is granted a life interest or is otherwise allowed to live in the house until their death.
14. Where the family member is granted a life interest, and the executors have completed their administration duties to the point of being ready to distribute, the house may be held on trust for the life tenant (and for the remainder beneficiaries - ie those who stand to inherit on the death of the life tenant). In that case, because a trust has arisen for the life tenant, from the date of distribution of the property to the trustees the trustees can apply to be excused from filing under s 43B.
15. The situation differs where the family member is granted only a licence to reside in the property. In that case another person will take the property subject to the licence under the will or intestacy. In some cases, the property subject to the licence may be distributed to a trustee to be held on trust for that other person (for example, where the other person is a minor). In that case s 43B may apply to the trust for the minor beneficiary if the licence allows the licensee to reside in the property for no consideration.

The Commissioner's approach

16. The Commissioner considers that executors and administrators are able to apply under s 43B to be excused from filing income tax returns where they have reached the point in administration of an estate that they are ready to distribute, or have distributed, the property in the estate to be held on trust for beneficiaries.
17. Executors and administrators who apply on this basis, or do so through their tax agent, will be excused if the trust in question meets the requirements of s 43B. They do not need to obtain a new IRD number for the trust, the number obtained earlier for the estate can be used.

    This Operational Statement is based on the Commissioner's view of the law at the date of issue and applies until the statement is withdrawn, amended or any law change occurs. A legislative change to s 43B that may alter some or all the matters covered in this statement is currently being considered by the Policy and Regulatory Stewardship Unit of Inland Revenue.

    This Statement was signed on 24 August 2021.

Rob Falk

National Advisor, Legal Services Technical Standards

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 21/04: Income tax and GST – deductions for businesses disrupted by the COVID-19 pandemic

Summary

1. Many businesses have faced significant disruption because of the COVID-19 pandemic.

   Some businesses have had to downscale or temporarily suspend their operations. Others have had to close completely. However, expenses and losses may still be incurred while the business is not operating. Whether a business has ceased operating temporarily or permanently has implications for whether it can claim income tax deductions for any expenditure or loss incurred.

2. An income tax deduction will usually be allowed where a business has downscaled or ceased operating temporarily, provided the general permission is satisfied (s DA 1) and the deduction is not disallowed by one of the general limitations such as the capital or private limitation (s DA 2). A deduction will usually be disallowed where a business has completely ceased, even if it is possible that the business may restart later.

3. Whether a business has ceased operating temporarily or permanently is a question of fact in each case. The nature of the activities carried on and the business's intention in engaging in those activities are relevant considerations.

4. Similar questions may arise for businesses in a GST context. If a registered person ceases to carry on a taxable activity they may be required to deregister from GST. If a person is deregistered for GST, because they have ceased to carry on a taxable activity or because they have chosen to deregister (perhaps because they do not expect to make taxable supplies exceeding $60,000 in the next 12 months), then they must make a deregistration adjustment and will be unable to claim any further input tax deductions.

5. For most taxpayers, determining whether their business activities have ceased temporarily or permanently will be straightforward. It will usually be obvious by the time a tax return is filed whether a business exists or not. However, if a business has ceased, it will be important to identify when this occurred because any expenditure or loss incurred after this point is unlikely to be deductible.

6. Examples are included from [63] to explain how the law applies.

Introduction

7. Many businesses have faced significant disruption because of the COVID-19 pandemic. For example, the tourism sector has faced disruption because border restrictions have prevented international tourists from entering New Zealand. Disruption has occurred in many other sectors as well.

8. Businesses have responded in different ways to this disruption. Some businesses have temporarily ceased or suspended their operations. Many businesses, such as restaurants and cafes, were unable to trade during Alert Level 4,[1] so had no option but to temporarily cease or suspend their operations. Other businesses permanently ceased operating; perhaps because they relied on international tourists. The Commissioner understands that some tourism businesses have ceased operating but hope to restart once the New Zealand borders open again.

9. In both scenarios, businesses may continue to incur expenses. The issue addressed in this Interpretation Statement is whether those expenses or losses are deductible when the business derives little or no income.

[1] For more information on New Zealand's alert levels, see *COVID-19 Alert System* (website, New Zealand Government, 2020).

Analysis

Deductibility

10. Section DA 1 contains the general rule allowing deductions. This is known as the general permission:

> **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.
>
> *General permission*
>
> (2) Subsection (1) is called the **general permission**.

11 A person is allowed a deduction for an amount of expenditure or loss to the extent that it is incurred[2] by them in deriving their assessable income, or in the course of carrying on a business for the purpose of deriving their income. These are sometimes referred to as the first and second limbs of s DA 1.

12. Businesses usually claim deductions under the second limb of s DA 1. The second limb allows deductions for business expenditure or loss and is considered broader than the first limb (*Europa Oil (NZ) Ltd v CIR (No 2)* (1974) 1 NZTC 61,169 (CA)).

13. Under the second limb, the expenditure or loss must be incurred "in the course of carrying on a business". Therefore, a sufficient relationship (or nexus) must exist between the expenditure and the business that is being carried on for the expenditure or loss to be deductible (*CIR v Banks* (1978) 3 NZTC 61,236 (CA) and *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA)).

14. Whether a business is being "carried on" is the main inquiry in this Interpretation Statement.

15. For completeness, note that even if a deduction is allowed under s DA 1, it may still be disallowed under s DA 2 if one of the general limitations applies, such as the capital or private limitation. In addition, the expenditure or loss may need to be apportioned between deductible and non-deductible amounts.

16. The principles of deductibility under s DA 1 are discussed in Interpretation Statement "IS 14/04: Income tax — Deductibility of company administration costs", *Tax Information Bulletin* Vol 26, No 7 (August 2014): 5, at [26]–[28].

Carrying on a business

17. In the context of this Interpretation Statement, it is assumed that before 21 March 2020 (before the lockdown period),[3] a business was being carried on for the purpose of deriving income and deductions were available for any expenditure or loss incurred. The issue is whether, from 21 March 2020, a business was still being carried on, so that any expenditure or loss incurred continues to be deductible.

18. "Business" is defined broadly in s YA 1 as including "any profession, trade, or undertaking carried on for profit".

[2] In the context of s DA 1, the word "incurred" has been held to mean that the taxpayer must have paid or become "definitively committed" to the expenditure or loss (*FCT v James Flood* (1953) 88 CLR 492 (HCA) and *CIR v Mitsubishi Motors NZ Ltd* (1995) 17 NZTC 12,351 (PC)).

[3] On 21 March 2020, the alert level system was introduced in New Zealand. The whole of New Zealand was initially placed at Alert Level 2.

19. The leading case on what constitutes a business is *Grieve v CIR* (1984) 6 NZTC 61,682 (CA). *Grieve* concerned a farming activity that, ultimately, did not generate any profits. The issue was whether the taxpayers were carrying on a farming business so they could claim deductions for losses incurred. The Court of Appeal held that whether a taxpayer is in business involves a two-fold inquiry as to the:
    - nature of the activities carried on; and
    - intention of the taxpayer in engaging in those activities.
20. In the leading judgment, Richardson J identified several factors relevant to determining whether a taxpayer is carrying on a business. These factors are the:
    - nature of the activity;
    - period over which the activity is engaged in;
    - scale of operations and the volume of transactions;
    - commitment of time, money and effort;
    - pattern of activity; and
    - financial results.
21. Richardson J also stated that it might be helpful to consider whether the operations involved are characteristic of that kind of business. However, ultimately, it is the character and circumstances of the particular venture that are crucial, at 61,691:

    > It may be helpful to consider whether the operations involved are of the same kind and are carried on in the same way as those which are characteristic of ordinary trade in the line of business in which the venture was conducted. However, in the end it is the character and circumstances of the particular venture which are crucial. Businesses do not cease to be businesses because they are carried on idiosyncratically or inefficiently or unprofitably, or because the taxpayer derives personal satisfaction from the venture.

22. Therefore, whether a business exists is a question of fact in each case. The *Grieve* test is discussed in more detail below.

Intention to make a profit

23. It is the taxpayer's subjective intention to make a profit that is relevant, although this must be objectively assessed.
24. A reasonable prospect of profit is not necessary. An actual intention, once established, is sufficient. However, if, realistically, there seems no real prospect of profit, then the taxpayer's claim that they genuinely intended to carry on a business for profit may be viewed circumspectly. Richardson J, in *Grieve*, stated (at 61,691) that while a taxpayer's statements as to their intentions are relevant, "actions will often speak louder than words".
25. A taxpayer will cease to be in business when it no longer has the intention to make a profit from the activities carried on (*AAA Developments (Ormiston) Ltd v CIR* (2015) 27 NZTC 22,026 (HC), *Case F31* (1983) 6 NZTC 59,712 (TRA), *Case G8* (1985) 7 NZTC 1,021 (TRA) and *Case J2* (1987) 9 NZTC 1,004 (TRA)).
26. Gendall J in *AAA Developments (Ormiston)* stated, at [48]:

    > At the outset I need to say that, as I see the position, the TRA [Taxation Review Authority] was correct in finding that the business of AAA ceased from 24 July 2008. AAA was incorporated for one reason, and one reason alone. That was to develop the Land. From the moment AAA attempted to accept Ormiston's otherwise invalid cancellation of the purchase agreement, it is difficult to accept AAA's argument that it still maintained some profit making intention from this point in time forward. Of course, in assessing this criterion it is necessary to have regard to statements made by a taxpayer. However, the ultimate analysis requires an assessment of a taxpayer's intention gleaned from all relevant circumstances.
    >
    > [Footnote omitted]

27. However, an intention to make a profit is not enough to establish that a business is being carried on. A business cannot exist simply in the mind of a taxpayer (*Calkin v CIR* (1984) 6 NZTC 61,781 (CA)). The nature of the activities carried on also need to be considered.

Nature of the activities carried on

28. The nature of the activities carried on must be sufficient to support the concept of a business (*Case L19* (1989) 11 NZTC 1,125 (TRA) and *Case H63* (1986) 8 NZTC 460 (TRA)). The factors Richardson J identified in *Grieve* (at [20]) may assist with this inquiry.

29. In *Slater v CIR* (1996) 17 NZTC 12,453 (HC), Fisher J explained that the taxpayer must engage in an operational activity that is relevant for the type of business that is being undertaken, at 12,460:

> The taxpayer must embark on the actual course of conduct which it is hoped would ultimately yield profit if persisted in. I do not think that merely setting up a business structure and purchasing plant or organising the decision-making structures, management and equity structures will suffice. That is not "carrying on a business" but "setting up a business". Nor do I think that activities which are confined to the organisation of relationships between proprietors, or the making of decisions over their future ownership of the business, would normally qualify because they are nonproductive of income. As I understand it there must be an operational activity. Other matters may well be pre-conditions to operational activity but will not suffice in themselves.

30. However, it is not necessary for a taxpayer to be actually trading or earning assessable income for deductions to be available. This is because the nature of a taxpayer's business may necessarily require expenditure and negotiations leading to contracts and to earning income (*Case M68* (1990) 12 NZTC 2,384 (TRA)).

31. Generally, a business will cease when it ceases trading. However, in *Case U29* (2000) 19 NZTC 9,273 (TRA), Judge Barber held that the particular facts of the case need to be examined to ascertain whether a business terminated when trading ceased. Judge Barber stated at [51]:

> It now seems to me that the tidying-up of the affairs of a business could often mean the continuance of the business for income tax purposes for a reasonable period beyond cessation of trading, but one needs to examine the particular facts of the case to ascertain whether or not the business terminated when trading ceased.

32. However, in *Case L89* (1989) 11 NZTC 1,508 (TRA), Judge Barber considered that this would not usually be the case and it would always be a question of fact.

Determining whether a business has ceased

33. If a business has completely ceased, it is generally unable to claim income tax deductions for any expenditure or loss incurred after cessation.[4] Therefore, it is important to determine whether, in fact, a business has completely ceased.

34. When applying the tests in *Grieve*, the courts have drawn a distinction between a "temporary cessation of business" (where the business activities have temporarily ceased or been suspended but will recommence) and "cessation with the possibility of recommencement" (where business activities have ceased and it is not certain that the business activities will recommence). Deductions are usually allowed for "temporary cessation" but not for "cessation with the possibility of recommencement".

35. This distinction was explained in *Case F73* (1983) 6 NZTC 59,931 (TRA). The taxpayer company was a partner in a fishing venture. In 1979, the skipper resigned and the boat stopped being used for fishing, although the partners continued to look for a new skipper. In 1980, the boat was removed from the water to reduce overheads and sale became a possibility. The boat was sold a year later. The taxpayer claimed a deduction for expenses incurred in the 1981 income year, arguing that at this stage, there was merely a temporary cessation of the fishing venture. They relied on attempts (that came to nothing) to set up share fishing or leasing arrangements with the boat.

36. Judge Barber held that by 1981 the business had ceased to operate and the partners were biding their time over the best course of action to take. This was not a temporary cessation, but a cessation with the possibility of recommencement:

> The source of income from fishing no longer existed well before 1 April 1980. I consider that there was not merely a temporary cessation of income earning operations in the partnership. **There was a cessation with the possibility of recommencement if a suitable operating structure could be worked out with a third party.**
>
> [Emphasis added]

37. *Case F73* predates *Grieve*, but Judge Barber still considered the nature of the operation and the intention of the taxpayer when deciding the issue. Although the taxpayer retained the main asset (the fishing boat) it was difficult to argue that a business was still operating when the boat was out of the water and had not been used for a long period. In addition, there was no skipper and no licence and the insurance policy for the boat had been changed from offshore to onshore. Judge Barber considered that, while the taxpayer (and the other partners) had explored various options to make a profit, ultimately their intention appeared to have been to sell the boat.

[4] However, there are some specific types of employment-related expenditure that may still be deductible following the cessation of a business – see ss DC 1, DC 2 and DC 10 of the Act.

38. *Case F73* referred to a similar decision by the Australian Supreme Court in *Queensland Meat Export Co Ltd v FCT* (1939) 4 ATD 176 (QSC). In this case, a meat works company temporarily closed for three years because of competition from a new abattoir in the area. After three years, the directors, who had intended to resume operations when conditions improved, decided to advertise the works for sale as a going concern. No offer was received, so the company sold the buildings, machinery and plant, but not the freehold land or wharf. The company claimed deductions during this period for expenditure incurred in guarding, insuring, maintaining and otherwise protecting the works. The company had continued its meat works business elsewhere in Queensland.

    The court held that the cessation of business was merely temporary.

39. In *Case F73*, Judge Barber considered whether the principles in *Queensland Meat* would apply, at 59,936:

    > …The Queensland company's cessation of its Brisbane works was temporary until 5 July 1934; O's cessation of fishing was permanent from at least June 1980. After 5 July 1934 the Queensland company's plant was held mainly for sale but also for use if conditions improved; there was no reasonable prospect of recommencement of fishing by the partnership as at 1 April 1980 and sale was contemplated at least by June 1980. The Queensland company still operated a similar business at other works and at all times carried on its overall business as one business which "was so treated in its balance sheet"; O's other business activities were not related to fishing and were accounted for separately. Both counsel dwelt on various passages in Douglas J's decision. I do not disagree with the principle of the following extracts from the judgment but they do not assist O in the circumstances of this case (p 493):
    >
    >> I think it is one of the incidents of a business of this kind that competition or other adverse condition may compel the owner to close down portion of its plant for an indefinite period. It is an ordinary business precaution that during such period the works and plant should be maintained so far as possible in good working order, whether the ultimate result be that they should again be opened or that they should be sold or eventually dismantled. ...
    >>
    >> The question whether the cessation of operations is merely of a temporary nature, or is one which has reached the final stage, is difficult to answer. ...
    >>
    >> Maintenance for a reasonable time of a plant which is about to be sold appears to me to be an incident of the business and to be an outgoing or loss in the gaining or producing of assessable income ...
    >>
    >> If money is so laid out in the hope that income may accrue from this works or plant in future, or to maintain it in proper order for a reasonable time awaiting sale, it is a proper deduction against profits, even though the profits come from another plant.

40. The court in *Queensland Meat* accepted that it may be an ordinary incidence of business to shut down for an indefinite period. However, drawing the line between a temporary cessation and cessation with the possibility of recommencement can be difficult. In *Queensland Meat*, although the company was contemplating a sale, it was still deriving income from other related activities that were part of the wider business. *Queensland Meat* can be contrasted with *Case F73* where the taxpayer had other business activities but they were unconnected to fishing.

41. In *Inglis v FCT* (1980) 80 ATC 4,001 (FCA), the Full Federal Court of Australia took the opposite view. The taxpayers owned a farming business but stopped actively farming after becoming involved in a legal dispute. They restricted their operations on the property and moved away for employment. The movable farm plant and machinery was disposed of and there was no stock on the property nor any income derived from the property for the relevant years. The taxpayers argued that while they had to restrict their expenditure on the business, they intended to resume it in the future. They claimed deductions for expenses relating to those years.

42. The court held that the business was no longer being carried on and disallowed the taxpayers' claim. Brennan J observed that the carrying on of a business was not just a matter of intention, but it was also a matter of activity, at 4,004:

    > …The carrying on of a business is not a matter merely of intention. It is a matter of activity. Yet the degree of activity which is requisite to the carrying on of a business varies according to the circumstances in which the supposed business is being conducted. Little activity may suffice for carrying on a business which does not call for much activity, as in *Thomas v. F.C. of T.* 72 ATC 4094; 46 A.L.J.R. 397 and in *Ferguson v. F.C. of T.* 79 ATC 4261. It must be remembered that "(b)usiness is not confined to being busy; in many businesses long intervals of inactivity occur" as Lord Sumner observed in *South Behar Ry. Co. Ltd. v. I.R. Commrs.* (1925) A.C. 476 at p. 488.

43. Brennan J stated that even if the intention of the owner was relevant in determining whether a business is merely going through a quiet period or has ceased, an intention to revive a business in the future does not prevent a finding that it has ceased to be carried on. Further, whether a business was being carried on could largely be determined by the extent of activity. Since all farming activities had stopped, it was held that no business was, in fact, being carried out on the taxpayer's property.[5]

44. Ultimately, whether a business has ceased is a question of fact in each case. However, it will be easier to argue a business is being carried on where it is well-established and it has kept its business structure and assets in place. Properly maintaining assets and expending time and effort on a relaunch will also support the argument that a business was continuing despite a hiatus.

Business disruption and the COVID-19 pandemic

45. Many businesses have faced significant disruption because of the COVID-19 pandemic. They have responded in different ways such as downscaling, temporary suspension or cessation of activities, permanent cessation, or cessation with the possibility of restarting. These responses are discussed next.

Downscaling a business

46. Some businesses have had to downscale their operations until conditions improve by reducing staff numbers or hours of operation. As long as there is still an intention to make a profit and sufficient operational activity (relevant to that type of business and current market conditions), then it is likely that a business is still being carried on and any expenditure or loss incurred can be deducted.

47. The courts have recognised that an enterprise can downscale without ceasing to be a business. In *Case F131* (1984) 6 NZTC 60,200 (TRA), Judge Barber held that, although the greater part of an enterprise may be sold and the balance continued for a time, it does not mean the owners are no longer in business. (In this case, Judge Barber found, as a matter of fact, that there was no business.)

48. However, there will come a point where the downscaling is to such a degree that it indicates the business has ceased. In *Case J78* (1987) 9 NZTC 1,459 (TRA), an elderly couple decided to reduce the area of their farm from 50 acres to four acres to cut costs and alleviate the physical burden of farming. They also decided to diversify their farming from annual crops to longer-term crops that required less effort. The longer-term crops were not readily available, so the couple continued to farm as usual, but only on the four acres. They farmed this way, knowing there would be little chance of a profit, and worked part-time jobs to supplement their income. The couple claimed deductions for business losses over the period. The Commissioner disallowed the claim on the basis that they had not been carrying on a business. Judge Barber agreed with the Commissioner. By farming on a reduced scale and with the knowledge that they would not make a profit, the taxpayers could not be regarded as carrying on a business. They continued to farm the land because their culture frowned upon land lying unused. The small amount of development activity was not enough to change this conclusion.

Temporary cessation of business activities

49. Some businesses have had to stop operating temporarily because of the COVID-19 pandemic. For example, during Alert Level 4, many businesses were required by law to cease trading. For many businesses, this would have been a temporary cessation of business. The business would have had the intention to make a profit, but, due to the lockdown, all business activity had to temporarily cease. The Commissioner considers that any expenditure or loss incurred during Alert Level 4 is likely to be deductible, provided there was still an intention to make a profit.

50. This temporary cessation of activities may have extended beyond Alert Level 4. Many businesses remained closed during Alert Levels 3 and 2. Depending on the business, and provided there was still an intention to make a profit, the Commissioner considers that any expenditure or loss incurred during these alert levels is also likely to be deductible.

Permanent cessation of business activities or cessation with the possibility of restarting

51. Not all businesses that stopped operating during the lockdown period would have done so on a temporary basis. If a business completely ceased trading during this period (for example, it laid-off staff, abandoned a lease, and returned stock), then there is no longer an intention to make a profit, so a business is not being carried on. It is irrelevant that the taxpayer might intend to start up the business later if conditions improve. A future intention to start up the business and to make a profit will not satisfy this test. Expenditure or loss incurred after a business has ceased is generally not deductible (*Case U29*).

[5] Note that the Australian income tax legislation definition of "business" does not require a profitmaking intention, but New Zealand income tax legislation does.

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52. In some cases, taxpayers may have decided to put their businesses up for sale during the lockdown period or even after it. Whether a business has ceased completely is a matter of fact. If the business intends to make a profit during this period and there is sufficient operational activity, then it is likely that the business is still being carried on. However, in *Case F31*, Judge Barber held that the taxpayer's intention to make a profit ceased on the date they decided to sell the property on which they carried on business, on the basis that they were no longer trading and had decided to sell.

GST and business cessation

53. Similar questions may arise for businesses in a GST context where the business has been disrupted because of the COVID-19 pandemic.
54. A person must be registered for GST to claim input tax deductions. The Commissioner can cancel a person's registration if they cease to carry on a taxable activity. In addition, a registered person can ask the Commissioner to cancel their registration if they have ceased to be liable to register (because the expected value of their taxable supplies in the next 12 months is not expected to exceed $60,000) (s 52 of the Goods and Services Tax Act 1985 (GST Act)).
55. "Carrying on a taxable activity" is a different test to "carrying on a business" in s DA 1. "Taxable activity" is defined in s 6(1) of the GST Act to mean:

> **Section 6 Meaning of term taxable activity**
>
> (1) For the purposes of this Act, the term **taxable activity** means—
>
> (a) any activity which is carried on continuously or regularly by any person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club:
>
> (b) limiting the generality of paragraph (a), the activities of any public authority or any local authority or public purpose Crown-controlled company.
>
> (2) Anything done in connection with the beginning or ending, including a premature ending, of a taxable activity is treated as being carried out in the course or furtherance of the taxable activity.

56. A taxable activity must be carried on "continuously or regularly". To be carried on "continuously", the activity cannot have ceased or been interrupted for any material period (*Wakelin v CIR* (1997) 18 NZTC 13,182 (HC)).
57. Section 6(2) extends the scope of s 6(1), by providing that anything done in connection with the ending of a taxable activity (including the premature ending of a taxable activity) is treated as being carried out in the course or furtherance of the taxable activity. This is the case, even if the taxable activity has ceased. Section 6(2) deems the taxable activity to have continued for anything done in connection with the ending of the taxable activity. Example 5 illustrates how this provision applies.
58. The COVID-19 pandemic may have resulted in some GST-registered businesses having to downscale or cease their taxable activities. The consequences for this are set out in s 52(1)–(5), (5A) and (7) of the GST Act:

Section 52 Cancellation of registration

(1) Subject to this Act, every registered person who carries on any taxable activity shall cease to be liable to be registered where at any time the Commissioner is satisfied that the value of that person's taxable supplies in the period of 12 months then beginning will be not more than the amount specified for the purposes of section 51(1).

(2) Every person who, by virtue of subsection (1), ceases to be liable to be registered may request the Commissioner to cancel that person's registration, and if the Commissioner is at any time satisfied, as mentioned in subsection (1), the Commissioner shall cancel that person's registration with effect from the last day of the taxable period during which the Commissioner was so satisfied, or from such other date as may be determined by the Commissioner, and shall notify that person of the date on which the cancellation of the registration takes effect.

(3) Every registered person who ceases to carry on all taxable activities shall inform the Commissioner of that fact within 21 days of the date of cessation and the Commissioner shall cancel the registration of any such person with effect from the last day of the taxable period during which all such taxable activities ceased, or from such other date as may be determined by the Commissioner:

provided that the Commissioner shall not at any time cancel the registration of any such registered person if there are reasonable grounds for believing that the registered person will carry on any taxable activity at any time within 12 months from that date of cessation.

(4) Any information provided by a registered person to the Commissioner under subsection (3) must include the date on which the person ceased to carry on all taxable activities and whether or not the person intends to carry on any taxable activity within 12 months from that date.

(5) Where the Commissioner is satisfied that a registered person is not carrying on a taxable activity the Commissioner may cancel that person's registration with effect from the last day of the taxable period during which the Commissioner was so satisfied, or from such other date as may be determined by the Commissioner, and shall notify that person of the date on which the cancellation of the registration takes effect.

(5A) Any date determined by the Commissioner for the cancellation of registration under subsection (5) may be retrospective to a date not earlier than—

(a) the last day of the taxable period during which taxable activity by the person ceased; or

(b) the date on which the person was registered under this Act, if the Commissioner is satisfied that the person did not, from that date, carry on any taxable activity.

(6) [Repealed]

(7) In subsections (5) and (5A), for a non-resident person who is not registered under section 54B, a taxable activity means a taxable activity carried on in New Zealand.

59. If the taxable activity has been downscaled to such an extent that it is not expected to make taxable supplies exceeding $60,000 in the next 12 months, the registered person can choose to deregister from GST (s 52(1) and (2) of the GST Act).

60. If a registered person is no longer carrying on a taxable activity because of the COVID19 pandemic, they need to inform the Commissioner within 21 days of cessation. The Commissioner may then cancel that person's GST registration. The Commissioner cannot cancel the person's GST registration if there are reasonable grounds for believing the person will carry on any taxable activity at any time within 12 months from the date of cessation (s 52(3) of the GST Act).

61. On ceasing to be registered for GST, the person must make a deregistration adjustment on the deemed supply of the assets used in their taxable activity (s 5(3) of the GST Act).

62. The Commissioner has issued a statutory variation[6] to provide limited relief for registered persons with a taxable activity of supplying accommodation: "COV 20/09: Variation to sections 52(3) and 52(4) of the Goods and Services Tax Act 1985", *Tax Information Bulletin* Vol 32, No 8 (September 2020): 22. The variation only applies to short-stay accommodation suppliers that, between 14 February 2020 and 31 October 2020, switched to making exempt supplies of longer-term residential accommodation, leaving them with no taxable activity. The cessation of the person's taxable activity during this period must have been because of the COVID-19 pandemic. In these circumstances, the Commissioner will not cancel the person's registration if there are reasonable grounds for believing they will carry on any taxable activity at any time within 18 months from the date their taxable activity ceased.

[6] Under s 6I of the Tax Administration Act 1994.

Examples

63. The following examples explain the application of the law. They concern the deductibility of expenditure or loss for the 2021 tax year and beyond. The examples assume:
    - the taxpayer was carrying on a business before the lockdown period;
    - none of the general limitations in s DA 2 apply;
    - the taxpayer was carrying on a taxable activity before the lockdown period; and
    - the taxpayer was registered for GST.
64. Some of the difficulty in determining what expenditure and losses are deductible in periods when a business has ceased operating is because of the uncertainty created by COVID-19. It is difficult to know when market conditions will improve and when the borders will reopen. However, in most cases, by the time the taxpayer files a tax return they will know whether their business activities have ceased temporarily or permanently. If business activities have ceased permanently, it will be important to identify when this occurred because any expenditure or loss incurred after this date is unlikely to be deductible.

Example 1 – English language school

Facts

English Language School Ltd operated a busy language school until the COVID-19 pandemic struck. All enrolled students were from overseas. When New Zealand entered Alert Level 4 (on 25 March 2020), the school had to close, and it remained closed until New Zealand returned to Alert Level 2 (on 13 May 2020).

Alert Levels 3 and 4

During the lockdown periods at Alert Levels 3 and 4, the school accessed the wage subsidy and continued to pay its staff. It also continued to pay rent, rates, power, water and insurance relating to the school building. During this time, no teaching took place, but the school's two shareholders continued to undertake marketing work and provide pastoral care to students that remained in New Zealand. They also used this time to investigate ways to provide online English language tuition.

At this time, the business has been downscaled. There is an intention to operate once the lockdown period is over. All activities undertaken during this period support this finding. Income tax deductions for expenditure incurred during this period are allowed. The school's GST-registration status does not change.

Alert Level 2

At Alert Level 2, the school opens its doors again but about 90% of its students have left New Zealand. Most students stay in New Zealand for about 11 weeks, so by now most have left and no new students will arrive due to border restrictions. When the wage subsidy ends, all staff are made redundant. The two shareholders continue to teach the 10% of students who remain. They also continue to work on marketing and developing online English language tuition technology.

The business continues to operate and income tax deductions for costs incurred during this period are allowed. While the business has been significantly reduced in size, this does not mean it has ceased. An intention to make a profit still exists (and the exploration of online learning possibilities supports this) and there is enough operational activity to support the finding that a business is being carried on. The school's GST-registration status does not change.

Alert Level 1

By 1 September 2020, all students have returned home and it is clear that online learning is not going to be a viable alternative to classroom learning. The school shuts down. The shareholders are hopeful that once the borders reopen, they will be able to start up again, but there is uncertainty about when this might occur.

Costs are still being incurred. The shareholders terminate the lease on the school building and must make a lease termination payment as a consequence. The school's assets (furniture, computers, books, stationery and so on) are put into storage and the school is charged a monthly fee. Some legal fees are incurred for advice on the redundancies and lease termination.

The Commissioner considers that from 1 September 2020, the business has ceased to operate. There is no longer an intention to make a profit because the school has shut down and is no longer operational. Expenditure incurred beyond this point is not deductible. For GST purposes, the shareholders have been advised to remain GST registered for a few months to ensure that input tax can be claimed on any costs incurred in winding-up the business (included as part of the taxable activity (s 6(2)). By the end of October, all activities relating to the wind-up have ceased and the shareholders notify the Commissioner under s 52(3) that from 31 October they have ceased to carry on a taxable activity. The Commissioner then cancels the GST registration from 31 October (s 52(5A)(a)) and the shareholders make a deregistration adjustment under s 5(3).

Establishment of a new business

After closing the school, the two shareholders decide to give online learning another try. They set up a new business, Online Home School Ltd. This time they are successful in attracting a small group of international students who are eager to learn English online. They run this business from their home.

Expenditure incurred on this new business is deductible. There is an intention to make a profit and the operational activity is sufficient to support the finding that a business is being carried on. However, because this is a new business, the shareholders are unable to deduct any of the costs that relate to the English language school business such as the monthly storage fees. Online Home School Ltd may need to register for GST if the shareholders expect its turnover will exceed $60,000 in the next 12 months.

Example 2 – Souvenir wholesaler

Facts

Magnets & More Ltd is a souvenir wholesale business, supplying New Zealand–themed souvenirs to retailers. Since New Zealand entered Alert Level 4 on 25 March 2020, the company has not made a single sale. Many of the company's retailer customers have closed and none are selling New Zealand–themed souvenirs.

Homer is the director and sole shareholder of Magnets & More. He is close to retirement age and is the company's only employee. The company owns the warehouse where the business is run from, and overheads are low. The company has about $100,000 of stock on hand and will not order any more for now.

Initially, Homer goes to the warehouse every day. He checks his emails for orders and makes calls to his customers. He keeps the warehouse clean and continues to pay a security guard service to monitor and patrol the building. However, by August 2020, it becomes clear to Homer that the New Zealand borders are likely to be closed for the foreseeable future.

With no other options available and no chance of leasing the warehouse in the current market, Homer decides to change focus. He shuts down his website and moves cities to help look after his grandchildren. He is hopeful that one day he may be able to start up the business again, but for now he will focus on his family.

Income Tax

During the 2021 tax year, the company continues to incur costs, including rates, power, water, security and insurance. Homer wants to know whether any of these costs are deductible.

The Commissioner considers that from August 2020 that Magnets & More has ceased to operate, so any expenditure incurred after this date will not be deductible. The complete lack of any operational activity during this time supports this conclusion. The nature of the company's activities during this period, the volume of transactions, the pattern of activity, the financial results and the commitment of time, money and effort, do not suggest an intention to make a profit.

The fact that Homer has retained the business assets for now (the remaining souvenirs and the building) does not mean that he continues to carry on a business.

GST

For GST purposes, Homer remains GST-registered for a few months to ensure that input tax can be claimed on any costs incurred in winding-up the business (included as part of the taxable activity (s 6(2)). By the end of March 2021, all activities relating to the wind-up have ceased and Homer notifies the Commissioner under s 52(3) that from 31 March he has ceased to carry on a taxable activity. The Commissioner then cancels his GST registration from 31 March (s 52(5A)(a)) and Homer must make a deregistration adjustment under s 5(3).

Example 3 – Fashion boutique

Facts

Angela is a sole trader who owns a fashion boutique in a tourist destination. She designs and hand-makes elaborate, embroidered jackets. The jackets are mainly sold to international tourists who visit the town.

When New Zealand entered Alert Level 4, Angela closed her boutique and put the unsold jackets into a special, climate-controlled storage facility to help preserve them. This facility costs Angela $50 a month. She gave notice on her lease but still had two months of payments to make. She continued to pay rates, insurance, power and water during this time.

During Alert Level 4 and later at Alert Level 3, Angela continued to work on her business from home. She set up an online boutique. However, over the next few months she failed to sell any of her jackets online, so she decided to diversify her business. She starts making cheaper, less elaborate clothing for the domestic market. She also picks up a contract to make uniforms for a local school. She decides to stop making embroidered jackets.

Income Tax

The Commissioner considers that while Angela's business operations temporarily ceased during Alert Levels 4 and 3, she continued to carry on a business, so any expenditure or loss incurred during this time will be deductible. Angela's intention was always to make a profit, and her decision to diversify her business and shift to an online store to generate income supports this intention. Looking at the nature of the business's activities during Alert Levels 4 and 3, there was a temporary reduction in the volume of transactions and financial results, but these rebounded quickly as the business diversified. Angela continued to commit time, money and effort to the business.

GST

For GST purposes, Angela continues to be GST-registered. She is still carrying on a taxable activity, her turnover exceeded $60,000 in the last 12 months, and she expects turnover will exceed $60,000 in the next 12 months. Even if her turnover is less than $60,000 in the next 12 months, Angela can choose to remain registered.

Example 4 – Boat cruise operator

Facts

Wiremu operates a harbour boat cruise business through his company. His customers are almost 100% international tourists. When New Zealand moved to Alert Level 4, Wiremu had no option but to close.

Wiremu plans to reopen during the school holidays and then, hopefully, to reopen fully in 18 months when the borders re-open.

Wiremu gets other flexible employment Monday–Friday to pay the bills. During weekends, he spends a few hours maintaining and running the boat and cleaning and repairing his premises. He occasionally orders fuel and parts from suppliers. He has also renewed his skipper license. After work, he regularly spends time updating his website and Facebook page, answering booking queries and dealing with refund requests. He researches market conditions and continues to advertise the business. He gets good bookings for the school holidays, so takes a break from his job and has a couple of successful weeks in September and October taking harbour cruises. Wiremu also operates for several days over the Christmas break, despite not being as busy as he used to be with international tourists.

From time to time, Wiremu speaks with the company he leases the boat from and the bank about his loans. The business still owns a ute that he makes payments on.

Income Tax

The Commissioner considers that the business continues to operate, just on a much reduced scale. Expenditure incurred during this period is deductible.

Wiremu still clearly has an intention to make a profit. He continues to keep the business assets clean and in working order and has reopened for periods, including the school holidays. He has renewed his skipper's licence and is taking bookings. Looking at the nature of the activities carried on, time, money and effort continue to be committed to the business. The underlying business structure and assets are still available for use, and the business continued to earn income at times throughout the year.

While the volume of transactions and pattern of activity have diminished considerably, this is consistent with the nature of the business as it has adapted to the new conditions New Zealand must operate under.

GST

For GST purposes, Wiremu's business continues to be GST-registered. He is still carrying on a taxable activity, his turnover exceeded $60,000 in the last 12 months and he expects it will exceed $60,000 in the next 12 months. Even if his turnover is less than $60,000 in the next 12 months, Wiremu can choose to remain registered.

Example 5 – Commercial property

Facts

Debbie owns a commercial property on the outskirts of a large city, carrying on the business of commercial leasing. Her tenant moved out shortly before New Zealand entered Alert Level 4. Since then, the property has remained vacant, despite this being an area with a shortage of commercial property spaces. Debbie continues to incur expenditure relating to the property such as council rates, water, power and insurance. She has made no efforts to advertise the property for lease and has engaged a valuer to value the property with a view to selling it.

Income Tax

The Commissioner considers that the business has ceased. Debbie no longer has an intention to make a profit. This is demonstrated by the fact she has not advertised the property for lease and obtained a valuation for the purposes of selling the property. In terms of the nature of the activity, no real operational activity (leasing or attempts at leasing) is taking place.

GST

Debbie may still claim back the GST on the valuation and will have to account for GST on the sale of the property because anything done in connection with the beginning or ending of a taxable activity is treated as being carried out in the course or furtherance of the taxable activity (s 6(2) of the GST Act). When her taxable activity has finally ceased, Debbie will need to notify the Commissioner under s 52(3). She will also need to make a GST deregistration adjustment under s 5(3).

Example 6 – Backpacker hostel

Facts

Malu owns and operates a backpacker hostel. His customers are mainly overseas students and travellers. The business had been struggling for a while with low occupancy rates. On 25 March 2020, things got considerably worse for Malu when New Zealand entered Alert Level 4. Customers stop arriving in New Zealand, and the hostel remains empty. This is the final straw for Malu and on 1 April 2020 he decides to close the doors on the hostel for good. He keeps busy teaching yoga and helping in a local cafe.

In December 2020, Malu is approached by a local orchard owner. The orchard owner would like to use Malu's hostel to house seasonal workers on favourable terms. Malu agrees and re-opens the hostel.

Income tax

The Commissioner considers that from 1 April 2020, there has been a permanent cessation of business, so expenditure incurred after this date is not deductible. Malu does not have an intention to make a profit, and there is insufficient operational activity to satisfy the business test.

However, the costs Malu incurs in operating the hostel from December 2020 for the seasonal workers will be deductible against that income.

GST

For GST purposes, Malu remains GST-registered for a few months to ensure that input tax can be claimed on any costs incurred in winding-up the business (including as part of the taxable activity (s 6(2)). By the end of July, all activities relating to the wind-up have ceased and Malu notifies the Commissioner under s 52(3) that from 31 July he has ceased to carry on a taxable activity. The Commissioner then cancels the GST registration from 31 July (s 52(5A)(a)). Malu makes a deregistration adjustment under s 5(3).

In December 2020, Malu restarts his activity. While he is arguably carrying on a taxable activity again, he does not believe that housing seasonal workers will generate taxable supplies over $60,000 in the next 12 months. He therefore decides not to register for GST.

Example 7 – Café

Facts

Ari operates a busy café in the Auckland CBD through his company Café Ltd. His customers mainly come from the surrounding businesses. When Ari set up the cafe, he purchased a new cooker and display cabinet. These acquisitions were funded by a bank loan. He has also outfitted a private function room at the back of the café with new tables and chairs. He intended to use this room for hosting catered functions.

On 21 March 2020, New Zealand entered Alert Level 2. Ari purchased hand sanitiser and masks for his staff and pens and clipboards for recording customer contact details. During this time, the number of customers dropped significantly. Many CBD workers chose to work from home. Those that came into the café were understandably concerned about the spread of COVID-19 and ordered their food to take away.

On 23 March 2020, New Zealand entered Alert Level 3. Given the restrictions placed on cafes and the fact that many of his customers were now working from home, Ari temporarily closed the café. Assisted by the wage subsidy, Ari was able to continue to employ his head chef Nina and three other staff members throughout Alert Levels 3 and 4.

On 13 May 2020, New Zealand was back at Alert Level 2 and Ari opened the café again.

Customer numbers were down and very few customers were dining-in. By 8 June 2020, New Zealand was at Alert Level 1 and many workers were back in the CBD. Business picked up again.

On 12 August 2020, Auckland was put into Alert Level 3. Ari tried to trade from a table at the front of the store. Again, with most of the CBD workers at home, he struggled to make any money. This pattern was repeated in the February 2021 lockdowns. Towards the end of February 2021, Ari made two staff redundant. He also sold the function room table and chairs, at a loss, as there had been no interest in using the dining room for private catered functions.

Income Tax

Throughout this period, Ari continues to carry on a business. The business had to temporarily stop trading during Alert Level 4 (and the first Alert Level 3), but there was still an intention to make a profit.

While the business has downscaled, all expenditure or losses incurred will still be deductible. This includes expenditure on hand sanitiser, masks and clipboards. It also includes rent, power, water, insurance, salary payments and KiwiSaver contributions. Redundancy payments are deductible under s DC 1 and the interest on the bank loan (used to acquire the cooker and display cabinet) is deductible under s DB 7.

Ari can also continue to claim depreciation deductions for his fixed assets – such as the cooker and display cabinet under s EE 6. It is not relevant that the cooker and display cabinet were not used during Alert Levels 3 and 4. They were available for use, which is sufficient for the purposes of s EE 1(2)(c).

Ari can also claim a deduction for the loss made on the sale of the private function room table and chairs.

GST

Ari continues to carry on a taxable activity. While his turnover has now slipped below $60,000, he expects to have a turnover in excess of $60,000 in the next 12 months so must stay GST-registered.

Ari must charge output tax on the sale of the function room table and chairs.

Example 8 – Guiding business to seed business

Facts

Martha ran a guiding business called “Lost in Nature” in one of New Zealand’s national parks. Her customers were mainly foreign tourists. The business operated from a small office near the entrance to the national park and it employed Martha and three guides. It owned two large 4-wheel drive vehicles for transporting customers and some specialist camping equipment.

From 19 March 2020, (when New Zealand closed its borders to international tourists), Martha suddenly had no customers. She struggled to attract New Zealand-based customers, despite a concerted marketing push. The business limped on through 2020 running weekly guided tours. However, the tours were often half-empty, and it was clear this would not be sustainable, especially when the wage subsidy ended.

Martha spent her spare time investigating the possibility of using some land she owned to plant native seedlings for sale. She has a background in horticulture and used her industry contacts to commission a short report. Based on this research, she was confident the business would be profitable. To get things started, Martha had her three employee-guides help her put up some fencing on the land and prepare the soil for planting.

In September 2020, with no likelihood of the border re-opening, Martha stopped advertising “Lost in Nature” and switched to growing and selling native seedlings. Her three employee-guides were employed in the new venture and the 4-wheel drive vehicles were adapted for carrying seedlings and supplies. Martha sold the specialist camping equipment at a loss.

Income Tax

During this time, “Lost in Nature” downscaled but continued to operate as a business until September 2020. All expenditure or losses incurred up to that point are deductible. There was an intention to make a profit and enough operational activity to satisfy the Commissioner that a business was being carried on.

The loss on the sale of specialist camping equipment is deductible as the sale occurred before the guiding business ceased operating. The sale did not give rise to depreciation recovery income.

Costs incurred in researching the feasibility of undertaking the plant business (including the report) are not deductible as they are feasibility expenditure incurred preliminary to or preparatory to the start of a business. Similarly, costs incurred in fencing and preparing the land for planting are capital costs. Fencing costs may be depreciable as land improvements under sch 13 of the Act.

GST

Initial orders in the seedling business suggest that Martha is likely to have a turnover exceeding $60,000 in the next 12 months. Therefore, she must keep her GST registration and cannot deregister. Because the vehicles and building will be used in the new taxable activity, she does not need to make a deregistration adjustment under s 5(3). The sale of the specialist camping equipment must be charged with GST output tax.

References

Legislative references

Income Tax Act 2007 – ss DA 1, DA 2, DC 1, DC 2, DC 10, YA 1 ("business")

Goods and Services Tax Act 1985 – ss 5, 6, 52

Tax Administration Act 1994 – s 6I

Case references

AAA Developments (Ormiston) Ltd v CIR (2015) 27 NZTC 22,026 (HC)

Buckley & Young Ltd v CIR (1978) 3 NZTC 61,271 (CA)

Calkin v CIR (1984) 6 NZTC 61,781 (CA)

Case F31 (1983) 6 NZTC 59,712 (TRA)

Case F73 (1983) 6 NZTC 59,931 (TRA)

Case F131 (1984) 6 NZTC 60,200 (TRA)

Case G8 (1985) 7 NZTC 1,021 (TRA)

Case H63 (1986) 8 NZTC 460 (TRA)

Case J2 (1987) 9 NZTC 1,004 (TRA)

Case J78 (1987) 9 NZTC 1,459 (TRA)

Case L19 (1989) 11 NZTC 1,125 (TRA)

Case L89 (1989) 11 NZTC 1,508 (TRA)

Case M68 (1990) 12 NZTC 2,384 (TRA)

Case U29 (2000) 19 NZTC 9,273 (TRA)

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

CIR v Mitsubishi Motors NZ Ltd (1995) 17 NZTC 12,351 (PC)

Europa Oil (NZ) Ltd v CIR (No 2) (1974) 1 NZTC 61,169 (CA)

FCT v James Flood (1953) 88 CLR 492 (HCA)

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

Inglis v FCT (1980) 80 ATC 4,001 (FCA)

Queensland Meat Export Co Ltd v FCT (1939) 4 ATD 176 (QSC)

Slater v CIR (1996) 17 NZTC 12,453 (HC)

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Other references

COVID-19 Alert System (website, New Zealand Government, 2020). **covid19.govt.nz/alert-system/**

"COV 20/09: Variation to sections 52(3) and 52(4) of the Goods and Services Tax Act 1985", *Tax Information Bulletin* Vol 32, No 8 (September 2020): 22. **taxtechnical.ird.govt.nz/tib/volume-32---2020/tib-vol32-no8**

"IS 14/04: Income tax – deductibility of company administration costs", *Tax Information Bulletin* Vol 26, No 7 (August 2014): 5. **taxtechnical.ird.govt.nz/tib/volume-26---2014/tib-vol26-no7**

IS 21/07: GST – Definition of a resident

Summary

1. This item provides guidance on the meaning of the term "resident" for GST purposes.

   The GST definition of resident differs from the income tax definition:

   - By extending it to include a person who is carrying on a taxable activity or other activity in New Zealand, if that person has a "fixed or permanent" place in New Zealand and that place relates to the activity in New Zealand. In this case the residency is "to the extent" of the New Zealand activity (discussed from [14]).
   - For unincorporated bodies, it provides for a residence test based on its centre of administrative management (discussed from [39]).
   - For individuals, the definition differs for the commencement and end dates of residency when applying the day-count test (discussed from [42]).

2. The importance of determining whether a person is a New Zealand resident for GST purposes is that it may affect whether GST needs to be charged on any supplies made to that person. It is also relevant to whether the person is required to charge and account for GST on supplies they make in New Zealand and whether a person can or is required to register for GST in New Zealand.
3. While many people are familiar with the income tax rules for determining residency and know whether they are resident under the Income Tax Act 2007 (ITA 2007), they may be unsure whether the connection or presence they have in New Zealand is sufficient for them to be treated as a resident for GST purposes.
4. The Commissioner discussed the law relating to determining whether a person is nonresident for GST purposes in "IS 21/03: GST – Registration of non-residents under section 54B" and in "IS 18/07: Goods and services tax – zero-rating of services related to land", *Tax Information Bulletin* Vol 31, No 1 (February 2019): 17. This statement is consistent with the analysis in IS 21/03 and IS 18/07.
5. This statement updates and replaces "GST: Scope of the term 'resident'", *Tax Information Bulletin* Vol 1, No 9 (March 1990) and "GST: The definition of resident", *Tax Information Bulletin* Vol 5, No 12 (May 1994).
6. For further information on residence for income tax purposes, see "IS 16/03: Tax residence", *Tax Information Bulletin* Vol 28, No 10 (October 2016): 2.

Introduction

7. Whether a person is resident for GST purposes is an important consideration for several matters relating to GST. For example, it is:
   - relevant to where supplies are treated as being made under s 8;[1]
   - a factor in determining the applicable rate of GST that may be chargeable on certain supplies under s 11; and
   - a requirement for non-resident registration under s 54B (see in "IS 21/03: GST – Registration of non-residents under section 54B", Inland Revenue 2021).
8. Most people are familiar with the income tax test for residency and know whether they are non-resident for income tax purposes. However, the GST definition of resident is wider, so some non-residents may be treated as a resident for GST purposes and may be unaware of the difference in the two definitions.

[1] Flowcharts providing an overview of the place of supply rules are in "IS 21/03: GST – Registration of non-residents under section 54B" (Inland Revenue, 2021).

Who is a resident for GST purposes?

Definition of resident – GST

9. The definition of "resident" in s 2 for GST purposes is:

   resident means resident as determined in accordance with sections YD 1 and YD 2 (excluding section YD 2(2)) of the Income Tax Act 2007:

   provided that, notwithstanding anything in those section, -

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

   (b) a person who is an unincorporated body is deemed to be resident in New Zealand if the body has its centre of administrative management in New Zealand:

   (c) the effect of the rules in section YD 1(4) and (6) of that Act are ignored in determining the residence or non-residence of a natural person, and residence is treated as—

      (i) starting on the day immediately following the relevant day that triggers residence under section YD 1(3) of that Act; or

      (ii) ending on the day immediately following the relevant day that triggers nonresidence under section YD 1(5) of that Act

10. First, the definition of "resident" refers to resident as determined under ss YD 1 and YD 2 (but not YD 2(2) of the Income Tax Act 2007). Section YD 1 sets out the rules for the residence of a natural person and section YD 2 sets out the rules for the residence of companies. For GST purposes, s 2 defines a "company" to include any limited partnership registered under the Limited Partnerships Act 2008.

11. Secondly, the definition of "resident" in s 2 modifies the income tax definition of resident by providing for three exceptions in paras (a) to (c):

    - Paragraph (a) refers to whether a person has an activity in New Zealand and a "fixed or permanent place" in New Zealand relating to that activity (see from [14]).
    - Paragraph (b) relates to unincorporated bodies (see from [39]).
    - Paragraph (c) relates to the effect of the day-count tests in the income tax residency tests (see from [42]).

12. If a person is a resident under s YD 1 of the Income Tax Act 2007, they will be resident for GST purposes, even if under a relevant Double Taxation Agreement the person's tax residence for income tax purposes is found to be in another jurisdiction. This might arise, for example, where a person retains a dwelling in New Zealand which is the person's permanent place of abode.

13. A non-resident is defined in s 2 to mean a person "to the extent that the person is not resident in New Zealand".

Resident "to the extent of" activity in New Zealand - para (a) of the definition of resident

14. Paragraph (a) of the definition of resident deems a person to be resident to the extent that the person carries on their taxable or other activity in New Zealand from a fixed or permanent place in New Zealand that is related to that activity.

15. Therefore, the main considerations to determine whether a person is deemed to be a resident for GST purposes relate to the meaning of:

    - "taxable activity or other activity";
    - "fixed or permanent place";
    - "relating to that activity or other activity"; and
    - "to the extent that" and whether a person can be both resident and non-resident for GST purposes.

Taxable activity or other activity

16. For the purposes of the resident definition, the focus of para (a) is on the activity being carried on by the person in New Zealand. The activity may be a taxable activity or any other activity, but in either case, the person will only be resident to the extent of the activity in New Zealand. In addition, while carrying on the activity the person must have a fixed or permanent place in New Zealand relating to that activity.

Taxable activity

17. A broad definition for this term is given in s 6(1)(a) with certain activities being specifically excluded in s 6(3):

> 6 Meaning of term taxable activity
>
> (1) For the purposes of this Act, the term taxable activity means—
>
> (a) any activity which is carried on continuously or regularly by any person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club:
>
> …
>
> (3) Notwithstanding anything in subsections (1) and (2), for the purposes of this Act the term taxable activity shall not include, in relation to any person,—
>
> (a) being a natural person, any activity carried on essentially as a private recreational pursuit or hobby; or
>
> (aa) not being a natural person, any activity which, if it were carried on by a natural person, would be carried on essentially as a private recreational pursuit or hobby; or
>
> (b) any engagement, occupation, or employment under any contract of service or as a director of a company, subject to subsection (4); or:
>
> (c) (i) any engagement, occupation, or employment—
>
> pursuant to the Members of Parliament (Remuneration and Services) Act 2013 or the Governor-General Act 2010:
>
> (ii) as a Judge, Solicitor-General, Controller and Auditor-General, or Ombudsman:
>
> (iia) pursuant to an appointment made by the Governor-General or the
>
> Governor-General in Council and evidenced by a warrant or by an Order in Council or by a notice published in the Gazette in accordance with section 2(2) of the Official Appointments and Documents Act 1919:
>
> (iii) as a Chairman or member of any local authority or any statutory board, council, committee, or other body, subject to subsection (4); or
>
> (d) any activity to the extent to which the activity involves the making of exempt supplies.

18. The main requirements of a taxable activity are:
    - there must be an activity;
    - that activity must be carried on continuously or regularly by a person; and
    - that activity must involve the making of taxable supplies.

19. Notably, however, s 6(3) excludes certain activities from being taxable activities.

    Examples of excluded activities are:
    - the making of exempt supplies (such as the supply of financial services and the supply of accommodation in a dwelling); and
    - private recreational pursuits or hobbies.

20. Determining whether a taxable activity is being carried on is always a question of fact. It involves examining all the circumstances of the particular case. The concept of a taxable activity is not considered further in this statement as it is covered in publications such as "IS 20/04: Goods and services tax – GST treatment of short-stay accommodation", *Tax Information Bulletin* Vol 32, No 6 (July 2020): 69.

Other activity

21. Paragraph (a) in the definition of "resident" also includes "other" activities in its scope.

    The terms "activity" and "other activity" are not defined in the Act.

22. The word "activity" has a broad meaning. It may refer to "a course of conduct or series of acts which a person has chosen to undertake or become engaged in": *Newman v CIR* (1994) 16 NZTC 11,229 (HC). Similarly, the Court of Appeal in *CIR v Bayly* (1998) 18 NZTC 14,073 said, at 14,078:

> In its standard dictionary usage, "activity" is "the state of being active; the exertion of energy, action" (Oxford English Dictionary). In the context of ss 6 and 8 [of the Goods and Services Tax Act 1985] it points to the combination of tasks undertaken, or course of conduct pursued by the registered person and whether or not it amounted to a business, trade or profession in the ordinary sense.

23. Both *Newman* and *Bayly* discuss the meaning of an "activity" in their discussion of a "taxable activity". The Commissioner's view is that "activity" in "other activity" bears the same meaning.
24. The reference to "other activities" expands the range of activities, so that not only "taxable activities" can result in residency under the Act. The word "other" implies that Parliament intended a wide variety of activities to be covered by para (a), which will include the activity of making exempt supplies.

Fixed or permanent place

25. For para (a) to apply, a person must also have a "fixed or permanent place" in New Zealand relating to the taxable or other activity in New Zealand. The term "fixed or permanent place" is not defined in the Act.
26. The word "place" indicates a physical location or a link to a particular geographical point. The place must be "fixed" or "permanent". The ordinary meanings of the words "fixed" and "permanent" indicate that the physical location must be lasting and unchanging and not temporary.
27. The Commissioner notes that a similar concept of "fixed establishment" is used in the Income Tax Act 2007 and the phrase "permanent establishment" is used in New Zealand's double tax treaties. Case law discusses the meanings of these phrases, and the concepts overlap with the concept of a "fixed or permanent place".
28. The Commissioner's view is that the "fixed establishment" and "permanent establishment" concepts are not equivalent to "fixed or permanent place" under the Goods and Services Tax Act. This is because, for income tax purposes, the linkage required between a "permanent establishment" or a "fixed establishment" and a business is stronger than the linkage required, for GST purposes, between a fixed or permanent place and the New Zealand activity.
29. For income tax purposes, the fixed establishment is "*a fixed place of business in which substantial business is carried on by the person*". The requirement to carry on a business through the fixed place is also included in the definition of a permanent establishment, which refers to "*a fixed place of business through which the business of a person … is wholly or partly carried on*". For GST purposes, the definition of resident requires that the "fixed or permanent place" simply relates to the activity that is being carried on. It does not require that the activity amount to a business, nor does it require that the activity be carried on in or through the fixed or permanent place.
30. In addition, the income tax terms are defined to specifically exclude a number of establishments (such as, facilities for storage, display or delivery) while the GST definition is general in its terms. However, the Commissioner accepts that the various commentaries relating to the *OECD Model Tax Convention* and the *OECD Multilateral Convention to Implement Tax Treaty Related Measures to prevent BEPS* may be useful in understanding the similarities and differences in the terms.

"Having" a fixed and permanent place "relating" to the activity

31. Having a fixed or permanent place looks at the connection between the person and the place. "Having" a place does not require ownership or a formal lease of the physical location but will require the person to have a place at their disposal, or available for their use, relating to their New Zealand activity. As para (a) refers to the person "having a *fixed or permanent* place", the relationship that the person has with the place must be enduring or lasting as opposed to temporary.
32. Finally, if the person has a fixed or permanent place, that place must be related to the taxable activity or other activity in New Zealand. This means that there must be a connection between the activity and the place. This is illustrated in *Example 1 to Example 5 and Example 8 and Example 9*.
33. The ordinary meaning of "relating" is a connection between things: *Concise Oxford English Dictionary* (12th ed, Oxford University Press, Oxford, 2011). This suggests a degree of connection is required between the fixed or permanent place and the relevant activity.
34. The context of the provision does not appear to require a departure from the ordinary meaning of "relating to". The provision is part of the definition of "resident" in the Act, which affects both the imposition of GST on supplies under s 8 and whether supplies can be zero-rated under the zero-rating provisions. In general, these provisions are intended to give effect to the destination principle, under which supplies of goods and services are taxed in the jurisdiction where the goods and services are consumed. Requiring a connection between a person's activity in New Zealand and a fixed or permanent place in New Zealand before the person is considered resident for GST purposes (and subject to GST at the standard rate) is consistent with that purpose.

35. In *Example 6 and Example 7* the non-resident company owns property in New Zealand. In both *Example 6* and *Example 7*, the property does not "relate to" the taxable activity carried on in Australia but is related to an activity of making accommodation available in New Zealand.

"To the extent that"

36. For GST purposes, a person is deemed to be resident in New Zealand "to the extent that" the person carries on, in New Zealand, any taxable activity or any other activity while having any fixed or permanent place in New Zealand relating to that taxable activity or other activity.
37. Similarly, the definition of "non-resident" in s 2 states that non-resident "means a person to the extent that the person is not resident in New Zealand" [emphasis added].
38. The use of the phrase "to the extent that" means that a single legal person can, for the purposes of the Act, be both resident and non-resident. In *Example 6 – Holiday house in New Zealand* and *Example 7 – Holiday house used as a place of residence and home office*, the non-resident company is treated as resident for GST purposes to the extent of the activity of providing accommodation in New Zealand.

Unincorporated bodies – para (b) of the definition of resident

39. Paragraph (b) of the definition of resident provides that an unincorporated body will be deemed to be resident in New Zealand if the body has its centre of administrative management in New Zealand.
40. This is necessary to provide clarity for unincorporated bodies who can register under the Act. This is because unincorporated bodies are not separate legal entities for income tax purposes, so cannot establish their residency under any specific income tax rules.
41. The "centre of administrative management" test is a factual enquiry that focuses on where the day-to-day administrative management of the unincorporated body is carried out, rather than the controlling or superior management function. This means that the centre of administrative management is where the day-to-day business is carried on as opposed to where the unincorporated body is ultimately controlled from.

Day-count tests – para (c) of the definition of resident

42. The residency status of a natural person for income tax purposes is based on two rules:

    the permanent place of abode test and the day-count rules. There are two "day-count" rules:

    - Section YD 1(3) of the ITA 2007 provides that a natural person is a New Zealand resident if they are personally present in New Zealand for more than 183 days in total in a 12-month period. For income tax purposes, s YD 1(4) of the ITA 2007 treats the person as a resident from the first of those 183 days.
    - Under s YD 1(5) of the ITA 2007, a person who is a resident under the day-count test provided in s YD 1(3) stops being a resident if they are personally absent from New Zealand for more than 325 days in total in a 12-month period. Again, for income tax purposes, s YD 1(6) of the ITA 2007 treats the person as not resident from the first of those 325 days.[2]
43. For GST purposes, para (c) modifies the day-count tests used when determining the residence and non-residence of a natural person so that the rules in s YD 1(4) and (6) of the ITA 2007 are ignored and the start and end dates are prospective, commencing on the day after the relevant day that triggers the residence or non-residence:

    (c) **the effect of the rules in section YD 1(4) and (6) of that Act are ignored** in determining the residence or non-residence of a natural person, and residence is treated as—

    (i) starting on the day immediately following the relevant day that triggers residence under section YD 1(3) of that Act; or

    (ii) ending on the day immediately following the relevant day that triggers nonresidence under section YD 1(5) of that Act [Emphasis added]
44. The reason for this difference is to ensure that when supplies are made, a supplier can apply the correct GST treatment based on the residency of the recipient at the time the supply is made.
45. Before para (c) was amended to read as quoted in [43], the rules led to uncertainty for suppliers. For example, a supply to a

[2] For further information on the income tax residency tests, see "IS 16/03: Tax residence", *Tax Information Bulletin* Vol 28, No 10 (October 2016): 2.

non-resident who was outside New Zealand at the time of the supply, might be zero-rated. However, that might have later been found to be incorrect if the recipient's New Zealand residence was backdated under s YD 1(4) or s YD 1(6). This is illustrated in *Example 11 – Residence – Day-count tests.*

46. The amendment ensures the supplier can establish the correct GST treatment at the time of supply.

Branches and divisions

Overview

47. Where a registered person carries on a taxable activity in branches or divisions, s 56 allows the person to apply to the Commissioner to register the branch or division as a separate registered person.

48. A requirement for registering the branch or division as a separate person is that each branch or division maintains an independent system of accounting and can be separately identified, either by reference to the nature of the activities carried on or the location of the branch or division (s 56(2)).

49. A non-resident person, who has a branch or division making supplies in New Zealand, may apply to have that branch or division registered under s 51. The branch or division is then treated as a separate person for GST purposes (s 54B(5)).

50. If the branch or division is registered in New Zealand (under s 51) and has a fixed or permanent place relating to the activity carried on, the branch or division may be resident for GST purposes under para (a) of the definition of resident.

51. Because the registered branch or division is treated as a separate person for GST purposes, the non-resident person can maintain their non-resident status. This means the non-resident may be able to register under s 54B (provided they meet all the requirements of s 54B(1)). This is illustrated in *Example 10 – Non-resident company with a New Zealand–based branch*. For further details about the registration of nonresidents, see "IS 21/03: GST – Registration of non-residents under section 54B" (Inland Revenue, 2021).

52. It is important to note that there are separate obligations on non-resident or "overseas companies" under the Companies Act 1993. A non-resident company, as an "overseas company" who is "carrying on business in New Zealand", is required to be registered under the Companies Act 1993 (s 334). Registration, by itself, of the non-resident company under the Companies Act does not give rise to residence under the GST Act.

Further rules for branches or divisions– s 56B

53. Section 56B contains further rules for branches or divisions. This provision applies to certain supplies of imported goods and services which are subject to a reverse charge. These are supplies treated by s 8(4B) as made in New Zealand or, where a liability for output tax has arisen under s 20(3JC). The reverse charge requires the recipient to account for output tax on the supply.

54. Section 56B will only apply to a person if they carry on activities both inside and outside New Zealand, through branches or divisions. For this purpose, a branch or division includes a head office of a company.

55. Section 56B provides that for this purpose each branch and division:
    - is treated as a separate person, carrying on a separate activity;
    - inside New Zealand is treated as a resident; and
    - outside New Zealand is treated as a non-resident.

56. Importantly, s 56B(4) provides that these rules apply whether or not the branch or division is registered for GST under s 56.

57. The reason for the introduction of s 56B was to clarify that a supply which is subject to the reverse charge provisions, between branches or divisions (including a Head Office) of an entity that operates both in New Zealand and outside of New Zealand, is treated as a supply, even though the parties may be a single legal entity.

58. For further information about the rules related to:
    - imported services, see "GST on cross-border supplies of remote services", *Tax Information Bulletin*, Vol 28, No 6 (July 2016): 12;
    - imported goods, see "GST on low-value imported goods", *Tax Information Bulletin*, Vol 31, No 8 (September 2019): 2; and
    - later amendments, see "GST on low-value imported goods remedials", *Tax Information Bulletin*, Vol 32, No 4 (May 2020): 81.

Examples

59. The following examples demonstrate how the rules will likely apply in different scenarios.

Example 1 – When a person is resident for GST

Overseas engineering company BWBuild Co is not resident in New Zealand under s YD 2 of the ITA 2007. The company has a contract to perform in New Zealand.

The contract requires BWBuild to provide design services and oversee the construction of an irrigation plant. The company leases, for a 12-month term, office space in a local building from which it carries out the services under the contract. During the term of the lease, BWBuild is carrying on its taxable activity in New Zealand while having a lease of the office space.

In this instance, the office space constitutes a fixed or permanent place relating to the activity of providing design services and overseeing the construction of an irrigation plant. The office space is at the disposal of the company for the term of the lease. A 12-month term is of sufficient duration to have an element of permanence. Therefore, BWBuild is deemed resident for GST for the activities it carries out under the contract.

Example 2 – Not resident – no fixed or permanent place

Following on from *Example 1*, two years later, BWBuild Co is asked to provide consultancy services to Design Co, a company that is providing similar design services. The contract provides that BWBuild will train Design staff on the use of software BWBuild developed. For this contract, it is agreed BWBuild will provide two staff for an initial period of six weeks and further support, as required, over the following three months. The staff will work out of Design's premises.

During this period BWBuild is carrying on a taxable activity in New Zealand in providing the services under the contract.

BWBuild does not lease or own or have any other arrangements for any other premises in New Zealand at this time. While BWBuild can use Design's premises for the purpose of carrying out the services under the contract, its staff have a limited right of access to the premises and for a short period of time. On these facts, BWBuild does not have a "fixed or permanent" place, as Design's premises are not at BWBuild's disposal during the term of the contract. Therefore, BWBuild is not a resident for GST purposes in relation to the activities under this contract.

Example 3 – Not resident – no fixed or permanent place

Anakin Co is a non-resident entity that provides satellite data to customers outside New Zealand. It obtains the satellite data from its satellites sending the data back to earth through antennas around the world. As part of its operation, Anakin obtains the right to use an antenna owned and maintained by Lucas Farms in a rural New Zealand location.

Anakin wants to register under s 54B to claim back the GST component of any service charges from Lucas Farms and any other GST costs that may be charged in New Zealand in carrying on its activity. However, Anakin wonders whether the right to use the antenna might be treated as a fixed or permanent place, meaning Anakin would be treated as New Zealand resident for this activity.

While the antenna is fixed or permanently located on land, Anakin's arrangement with Lucas Farms does not give Anakin exclusive use of the antenna or enable it to make alternative maintenance arrangements. Therefore, the antenna or any associated space around it cannot be regarded as permanently at Anakin's disposal.

This arrangement to use the antenna does not mean Anakin has a fixed or permanent place in New Zealand. Therefore, under this arrangement, Anakin is not a resident for GST purposes in relation to this activity.

Example 4 – Supply of machinery to New Zealand – not a fixed or permanent place

Duke Engineering Co is a US-resident company that supplies, on a three-year lease, a large piece of machinery to Butler Co, a New Zealand manufacturing company. The machine remains the property of Duke and is to be removed from New Zealand at the end of the contract. Duke wonders whether having the machine in New Zealand might mean that Duke has a fixed or permanent place in New Zealand.

Duke is a manufacturer of equipment with a worldwide operation. It makes supplies of equipment by way of sale or lease. The machine is leased to Butler and housed in Butler's premises. While the lease of the machine is for a period that has an element of permanence, the machine itself is not a fixed or permanent "place" that Duke has relating to its activity in New Zealand. The premises in which the machine is located are also not available or at the disposal of Duke and cannot be regarded as a fixed or permanent place relating to their activities in New Zealand.

Example 5 – Staff seconded to New Zealand

Following on from *Example 4*, eight months into the lease, Butler Co contacts Duke Engineering Co to say it is having production issues with the machine. Duke agrees to send one of its engineers (Harry) to New Zealand to tune up the machine and train the local staff during the contracted warranty and support period. The contract provides that the engineer will work on the premises and will use equipment supplied by Butler. Harry remains an employee of the US company during this time, but he works under day-to-day supervision of Butler. Butler reimburses Duke for Harry's salary costs. After five months, everything is working smoothly, and Harry returns to the US.

Although Duke is providing services in New Zealand during the warranty and support period, it has limited rights to Butler's premises. Harry's presence is only for the purpose of this contract. The premises are not at Duke's disposal, and therefore Duke does not have a fixed or permanent place relating to the activities carried on in New Zealand.

Example 6 – Holiday house in New Zealand

Baker Floyd is a marketing firm based in Australia. The company leases an apartment in Queenstown so that its directors and staff can holiday there. The lease is for a five-year term with a right of renewal for a further four years. The apartment is left unoccupied when not required by the directors or staff.

Baker Floyd does not carry on its taxable activity of providing marketing services in New Zealand as the activities it carries on are supplies of services made to customers in Australia. However, the making available of the apartment in Queenstown to its directors or staff is still an "activity". Whether the activity is a taxable activity depends on whether the supplies of the accommodation to its directors and staff are made for consideration and whether the activity, if it were carried on by a natural person, is a private recreational pursuit or hobby (s 6(3)(aa)).

The apartment is a place that is permanently available to Baker Floyd in New Zealand. Therefore, Baker Floyd has a place that is both fixed and permanent in New Zealand relating to the activity it carries on in New Zealand. Baker Floyd is resident "to the extent of" that activity. However, the apartment is not a fixed or permanent place relating to the Australian marketing activity.

If Baker Floyd makes taxable supplies in New Zealand by supplying accommodation in the apartment, Baker Floyd will need to consider whether to register for GST under s 51 in order to be entitled to claim back any GST input tax charged on supplies relating to the apartment in Queenstown.

Example 7 – Holiday house used as a place of residence and home office

Following on from *Example 6*, due to restrictions on travel during the COVID-19 pandemic, Baker Floyd is unable to use the Queenstown apartment for its intended purpose. However, Tom, a director of the company and a New Zealand resident, moves his family to New Zealand to be closer to his elderly parents. The Queenstown apartment is now the family home of Tom and Mary and their children.

Tom continues working for the company and has an office set up in the apartment. He has regular Zoom meetings and phone calls and continues to negotiate contracts with customers in Australia.

Baker Floyd is still carrying on two activities. It is still making supplies of marketing services to customers in Australia. Also, Baker Floyd is carrying on the activity of providing accommodation in the apartment in New Zealand to Tom and his family.

The apartment is a fixed or permanent place that relates to only one of the activities carried on by Baker Floyd. This is the activity of providing accommodation in the apartment to Tom and his family. This is likely to be an exempt supply of accommodation in a dwelling (s 14(1)(c)). This means Baker Floyd is resident for GST purposes, "to the extent" it carries on activities in New Zealand while having a fixed or permanent place "relating to" the activity.

However, as Baker Floyd is making exempt supplies in New Zealand it will not have any output tax liability. Also, it will not be able to claim back any input tax on expenses such as power or rates incurred for the property, as these will not be acquired for the purposes of making taxable supplies in New Zealand.

Example 8 – Use of a logistics facility

TransformU Co is an American wholesaler that, from time to time, imports yoga and Pilates fitness equipment into New Zealand for supply to fitness studios in New Zealand and Australia. The goods are stored at the warehouse of logistics firm Palatine Xpress Co. An employee of Palatine assists with the importation documents in New Zealand. The goods are stored until TransformU directs them to be shipped to New Zealand or Australian customers and are stored as part of the service supplied by Palatine.

TransformU makes no supplies in New Zealand to unregistered customers. Therefore, although the goods are in New Zealand at the time of supply, they may be treated as supplied outside New Zealand under s 8(4). TransformU pays a storage fee based on the cubic area the goods occasionally occupy. It also pays service fees for the importation assistance and transport of the goods. TransformU is not treated as a New Zealand resident for GST purposes as it does not have a fixed or permanent place in New Zealand.

TransformU could consider registering under s 54B to claim back any input tax incurred. Registration under s 54B would enable TransformU to claim back the GST incurred on the logistics service provider's fees but will not enable the claiming back of the GST charged under s 12(1) on importation of the goods into New Zealand. This is because, when a non-resident registered under s 54B imports goods that are to be delivered to another person in New Zealand, s 20(3LC) treats the recipient of the goods as having paid the GST and the nonresident as not having paid the tax. See IS 21/03: *GST – Registration of nonresidents under section 54B*, for more information.

Example 9 – Lease of part of a logistics warehouse

TransformU has seen increasing demand for its equipment and wants to extend the range of goods it will supply. Several potential customers have asked whether they can view a sample of the goods before placing an order. TransformU enters into a contract with Palatine to have an area adjacent to the general warehouse set aside for their exclusive use. This includes a display area for potential customers to view the products. The ability to view the products at this location is advertised on their website. The contract term is for 12 months, with a right of renewal for a further 6 months.

The leased space is at the disposal of TransformU and is related to the activity of promoting and supplying the goods in New Zealand. TransformU therefore is carrying on an activity in New Zealand while having a fixed or permanent place in New Zealand relating to the activity.

Example 10 – Non-resident company with a New Zealand–based branch

Cavolo Management Co is an overseas-registered company with a branch based in New Zealand. Cavolo applies under s 56 to have its branch CavoloNZ registered for GST.

The head office of Cavolo plans to send two of its senior employees to a management conference in Auckland and has paid their conference fees. It asks whether it could register separately from CavoloNZ under s 54B to claim back the GST incurred on its employees' expenses in attending the conference.

The head office of Cavolo may register separately from its New Zealand branch, under s 54B, to claim back the GST incurred provided the costs relate to the overseas-based business activities and do not relate to the taxable activity of the New Zealand branch.

Example 11 – Residence – Day-count tests

Anna is an Australian chef living in Melbourne. She arrives in New Zealand on 18 May 2021 and takes a temporary job in a Nelson restaurant. On 13 June 2021 she returns to Melbourne.

Anna really enjoyed her time in New Zealand and is considering returning and opening her own food truck business in New Zealand. She contacts John, a New Zealand lawyer for advice on what the legal requirements would be. John invoices her for the advice on 28 July 2021. He zero-rates the supply because the advice is to a non-resident, who is outside New Zealand at the time he gives the advice.

Anna returns to New Zealand on 11 August 2021 and takes up another temporary chef's position while she looks for a suitable food truck opportunity. In October Anna finds a food truck for sale and agrees to purchase it. Settlement will take place on 1 February 2022.

Based on the day-count tests, Anna will become a New Zealand resident for GST purposes on 14 January 2022. This is because she will then have been personally present in New Zealand for more than 183 days in a 12-month period. She is present for 27 days in May and June, and a further 156 days from 11 August to 13 January 2022. Under para (c) of the definition of "resident", she is treated as resident for GST purposes starting on the day immediately after the day that triggers residence under s YD 1(3) of the ITA 2007. Anna is therefore resident for GST purposes from 14 January 2022 (the day after 13 January 2022). Therefore, John correctly zero-rated the supply of advice to Anna in the invoice dated 28 July 2021.

For income tax purposes Anna would be treated as a resident from the first day of the 183-day period under s YD 1(4) ITA 2007, so from 18 May 2021 (presuming she did not have a permanent place of abode in New Zealand prior to that date).

References

Legislative references

Companies Act 1993 – s 334

Goods and Services Tax Act 1985 – ss 2 ("non-resident", "resident"), 6(1) and (3), 8, 11, 14, 20(3JC), 51, 54B(5), 56, 56B

Income Tax Act 2007 – s YD 1(3)–(6), 2(1)

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LEGISLATION AND DETERMINATIONS

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

Determination EE003 – Payments provided to employees that work from home; Employee use of telecommunications tools and usage plans in their employment

Application

Determination EE003 (the Determination) applies to relevant payments made by employers for the period from 1 October 2021 to 31 March 2023.

Background

1. Amounts paid by an employer to an employee to reimburse that employee for costs that they incur in connection with their employment are taxable in the hands of the employee unless the payment is exempted by the provisions of s CW 17 of the Income Tax Act 2007.
2. Under s CW 17 a reimbursing payment is treated as exempt income to the employee to the extent that the expenditure in question would be ordinarily deductible to the employee if the employment limitation did not apply. The employment limitation is the rule that prevents an employee from claiming most deductions for expenditure incurred in deriving employment income.
3. As the expenditure in question must also be ordinarily deductible, there needs to be a connection between the expenditure and the performance of the employee's job. It also means that the expenditure cannot be private expenditure or expenditure of a capital nature (however, an amount can be paid for a depreciation loss).
4. Employers may find it administratively difficult to establish the extent to which expenditure is incurred by employees in connection with their employment income or is of a private or capital nature. They may also find it difficult to establish or realistically estimate the expenditure each of their employees has incurred (or is likely to incur).
5. To remove some of this difficulty and reduce the compliance costs for employers, the Commissioner of Inland Revenue (the Commissioner) has, over the past two years, published several determinations that deal with the additional expenditure that employees may face when they work from home and/or use their personal telecommunications tools and usage plans in their employment.

DET EE001 Determination EE001: Employee use of telecommunications tools and usage plans in their employment

6. In December 2019 the Commissioner issued Determination EE001. This determination provided guidance on arrangements where employees agree to use their own telecommunication devices and/or usage plans for their employment. EE001 sets out proportions of expenditure or loss that the Commissioner accepted as being exempt income of an employee. The proportions differed depending on whether a device or usage plan is used by the employee principally for employment.
7. EE001 also provided a *de minimis* rule which treated a payment made to an employee of up to $5 per week as exempt income of the employee. All that was required for this *de minimis* rule to apply was for there to be an arrangement where the employee provided their own telecommunications tools and usage plan, or just their usage plan, and the employee agreed to use these for their employment.
8. Determination EE001 could be used in relation to payments made to employees for mobile phone and internet costs incurred by employees as an ordinary incident of their day-to-day employment. The payment could be made irrespective of where the employee worked from; the determination was not limited to those employees that worked from home.
9. It should be noted that Determination EE001 was "open ended"; it did not have a cessation date. Amalgamating all previous determinations into this determination means that all the provisions previously contained in those determinations now have a consistent end date (of 31 March 2023).

10. Although Determination EE001 is now being amalgamated into this determination, its contents remain unchanged, other than for the inclusion of an end date. **In particular, employers that wish to reimburse those employees that are required to use their personal telecommunications tools and/or usage plans in their employment may do so, even where the employee is not required to work from home.** See [28] and [29] for further discussion on this topic.

Determination EE002: Payments to employees for working from home costs during the COVID-19 pandemic

11. During the initial COVID-19 pandemic national lockdown, some employers made payments to employees to reimburse the additional costs incurred by those employees in having to work from home. Inland Revenue was asked to clarify the tax treatment of such payments.
12. Subsequently Determination EE002 was published in April 2020. Determination EE002 was issued as a temporary response to the COVID-19 pandemic and applied to reimbursement payments of up to $15 per week, made by employers during the six-month period from 17 March to 17 September 2020, so long as the employee who received the payment was working from home as a consequence of the COVID-19 pandemic. Where this occurred, the reimbursement payments were exempt income.
13. The $15 amount that was able to be treated as exempt income excluded payments made to reimburse employees for the use of their personal telecommunications tools and usage plans. Effectively this meant that, where appropriate, employees that incurred expenditure for both working from home and the use of their personal telecommunications tools and/or usage plans, they were able to be reimbursed a total of $20 per week and have that amount treated as exempt income.
14. To ensure that these payments continued to be treated as exempt income after the lockdown period ended, the Commissioner issued *Determination EE002A: Variation to Determination EE002 - Payments to employees for working from home costs during the COVID-19 pandemic.* This determination mirrored Determination EE002 but extended the timeframe of the determination out to 17 March 2021. It also removed the requirement that the expenditure or loss must be incurred by the employee because the employee was required to work from home because of the COVID-19 pandemic.
15. In February 2021 this timeframe was further extended to 30 September 2021 by the issue of *Determination EE002B: Variation to Determination EE002A - Payments to employees for working from home cost.* As with the previous determination extension, determination EE002B applied to any payment made to an employee that worked from home, to the extent it was to reimburse that employee for costs incurred in working from home. This meant that, where appropriate, employees that incurred expenditure on both working from home and the use of their personal telecommunications tools and/or usage plans continued to be able to be reimbursed a total of $20 per week.

    As it is now necessary to extend determination EE002B beyond that determinations' expiry date of 30 September 2021, the Commissioner has decided to take this opportunity to make it easier for employers and employees to locate the information that they require by amalgamating all previous determinations into one publication.

Determination

This Determination is made under s 91AAT of the Tax Administration Act 1994 and s CW 17(2C) and (2D) of the Income Tax Act 2007. It may be cited as; Determination EE003: *Payments provided to employees that work from home; Employee use of telecommunications tools and usage plans in their employment* and it applies to the following payments made by employers for the period from 1 October 2021 to 30 March 2023.

This determination's requirements and exclusions

16. For this Determination to apply:
    - An employer must make a payment to an employee.
    - The payment must be for expenditure or a loss incurred (or likely to be incurred) by the employee.
    - The expenditure or loss must be incurred by the employee in deriving their employment income and not be private or capital in nature (the capital limitation does not apply to an amount of depreciation loss).
    - The payment must be made because the employee is doing their job and the employee must be deriving employment income from performing their job.
    - The expenditure or loss must be necessary in the performance of the employee's job.
    - Where an employee is partly working from home and partly outside of their home, the home-based work must be more than minor. For example, the Determination can apply to an employee who works at the employer's premises on alternate days.

17. This Determination does not apply to:
    - Any payment that is already the subject of a payment as expenditure on account of an employee[1].
    - Any payments made for a period after an employee ceases to work from home (other than telecommunications payments made in accordance with [28] of this determination).
    - An amount paid under a salary sacrifice arrangement.

This determination is not binding on employers or employees

18. This Determination is not binding on employers or employees. An employer or employee may treat a different amount paid to the employee as exempt if they have evidence to demonstrate that in their circumstances some other amount is appropriately treated as exempt income.

Weekly thresholds of this determination

19. Under this determination, where an employer pays an employee who is working from home an allowance, or pays an allowance in respect of the employees use of their personal telecommunications equipment and/or usage plans (an "affected employee"), the most appropriate of the following options can be chosen and that amount treated as exempt income of the affected employee:

Where the affected employee works from home but does not use their own telecommunications tools and/or their own usage plans.

20. Up to $15 per week of the amount paid by the employer can be treated as exempt income of the affected employee. The same treatment can be applied to an equivalent amount paid for a different time period, $30 per fortnight for instance.
21. The Commissioner considers this to be a *de minimis* amount that recognises:
    - any potential increase in household costs that an affected employee may incur when working from home,
    - any amount of depreciation loss on existing depreciable assets (but see [33] – [44] in relation to newly acquired assets), but
    - excludes any reference to telecommunications tools and/or usage plans.

Where the affected employee both works from home and uses their own telecommunications tools and/or their own usage plans for their employment.

In this circumstance an employer and an affected employee may choose one of the following options:

The de minimis option:

22. Up to $20 per week of the amount paid can be treated as exempt income of the affected employee. The same treatment can be applied to an equivalent amount paid for a different time period, $40 per fortnight for instance
23. The Commissioner considers this to be a *de minimis* amount that recognises:
    - any potential increase in household costs that an affected employee may incur when working from home, and
    - telecommunications costs (previously set out in Determination EE 001), and
    - any amount of depreciation loss on existing depreciable telecommunications assets (but see [33] – [44] in relation to newly acquired assets).

Principally business use option:

24. Per [20], this option allows up to $15 per week of the amount paid to be treated as exempt income of the affected employee. The same treatment can be applied to an equivalent amount paid for a different time period, $30 per fortnight for instance. This amount excludes any amount paid in relation to the use of the affected employee's telecommunications usage plans.
25. In addition to this $15, where the affected employee uses their personal telecommunications tools and/or their usage plans principally for business purposes, employers can treat any reimbursement of up to 75% of the amount of the affected employee's total usage plan bill as exempt income of that employee. If the cost of the employee's usage plan is not a regular amount, then a reasonable estimate of the likely expenditure is acceptable. See [30] – [32] for further discussion regarding reasonable estimates.

[1] Per s CW 17(1) of the Income Tax Act 2007.

LEGISLATION AND DETERMINATIONS

An amount of depreciation loss on existing telecommunications assets that are owned by the employee may also be paid using the Commissioner's depreciation rates for the item (but see [33] – [44] in relation to newly acquired assets).

Principally private use option:

26. This option allows up to $15 per week of the amount to be treated as exempt income of the affected employee on the same basis as described in [24].

27. In addition to this $15, where the affected employee uses their personal telecommunications tools and/or their usage plans principally for private purposes, employers can treat any reimbursement of up to 25% of the amount of the affected employee's total usage plan bill as exempt income of that employee. If the cost of the employee's usage plan is not a regular amount, then a reasonable estimate of the likely expenditure is acceptable. See [30] – [32] for further discussion regarding reasonable estimates.

    An amount of depreciation loss on existing telecommunications assets that are owned by the employee may also be paid using the Commissioner's depreciation rates for the item (but see [33] – [44] in relation to newly acquired assets).

Where an affected employee does not work from home, but uses their own telecommunications tools and/or usage plans in the course of their employment

28. In this circumstance, an employer may choose one of the following options:

    - *de minimis option:* This option allows up to $5 per week of the amount paid to be treated as exempt income of the affected employee. The same treatment can be applied to an equivalent amount paid for a different time-period, $10 per fortnight for instance. The Commissioner considers that this *de minimis* amount recognises all costs that an affected employee may incur, including any amount of depreciation loss on existing depreciable telecommunications assets that the employee may use (but see [33] – [44] in relation to newly acquired assets).
    - *The principally business use option:* Per [25], employers can treat any reimbursement of up to 75% of the amount of the affected employee's total usage plan bill as exempt income of the employee. If the cost of the employee's usage plan is not a regular amount, then a reasonable estimate of the likely expenditure is acceptable. See [30] – [32] for further discussion regarding reasonable estimates.

    An amount of depreciation loss on existing telecommunications assets that are owned by the employee may also be paid using the Commissioner's depreciation rates for the item (but see [33] – [44] in relation to newly acquired assets).

    - *The principally private use option:* Per [27], employers can treat any reimbursement of up to 25% of the amount of the affected employee's total usage plan bill as exempt income of that employee. If the cost of the employee's usage plan is not a regular amount, then a reasonable estimate of the likely expenditure is acceptable. See [30] – [32] for further discussion regarding reasonable estimates.

    An amount of depreciation loss on existing telecommunications assets that are owned by the employee may also be paid using the Commissioner's depreciation rates for the item (but see [33] – [44] in relation to newly acquired assets).

29. This Determination does not apply where there is no employment income under the arrangement, that is, where the employer provides the telecommunications tool and pays for the usage. In such circumstances there may be FBT implications. It is noted that s CX 21 provides an exemption for business tools.

Reasonable estimate to be made

30. As is the case when making any apportionment to account for the business use of an asset, reasonable judgement must be exercised and there must be some reasonable evidential basis to justify the apportionment used.

31. However, it may be difficult to determine the level of use precisely and this Determination is intended to allow for less than precise estimation. The employer may for instance rely on some evidence of time spent to show that the asset is used principally for business purposes. However, the employer may instead choose to obtain a signed declaration from an employee that telecommunications tools will be used principally for employment purposes.

32. It is expected that the apportionment used would be reviewed periodically to check that the level of use remains the same. A review once every two years would be adequate. If an employer has obtained a signed declaration from an employee that telecommunications tools will be principally used for employment purposes, then a review is only required if there has been a material change to the employee's circumstances.

Payments for the cost of newly acquired furniture and equipment and telecommunications equipment

33. The Commissioner recognises that the employee may need to acquire personal home office furniture or equipment or telecommunications equipment to enable them to effectively work from their home. Where assets are acquired for this purpose, an employee would incur a depreciation loss which the employee would be able to claim as a deduction, but for the employment limitation[2].
34. Because of the low-value asset rule, for many assets the depreciation loss is likely to be equal to the cost of the asset.[3]
35. Where an employer wishes to reimburse the employee for the cost that they incurred in acquiring their home office furniture or equipment, this Determination provides that they can use one of the following options.
    - the safe harbour option for furniture and equipment and a separate safe harbour option for telecommunications equipment, or
    - the reimbursement option.

The safe harbour option

36. Under this option an employer can treat payments of up to $400 made to reimburse the employee for the costs incurred in acquiring new furniture and equipment as exempt income. Additionally, they may also treat payments of up to $400 made to reimburse the employee for the costs incurred in acquiring new telecommunications equipment as exempt income. Each of these $400 limits apply to the costs of ALL the furniture and equipment, and all telecommunications equipment that the employee acquires. It is not an item by item limit.
37. The safe harbour option saves an employer from having to identify the costs that their employees have or are likely to incur, and from having to make judgements about the extent to which the furniture or equipment is used by employees for their employment.
38. If an employer adopts this safe harbour option, they cannot treat any future allowance or reimbursement payment for any subsequent furniture or equipment, or telecommunications equipment purchases made by the employee as exempt income. It is not an amount that refreshes on a regular basis; annually for instance.

The reimbursement option

39. Under this reimbursement option, an amount paid by an employer will be exempt income of an employee if:
    - The amount is for furniture or equipment or telecommunications equipment purchased by the employee to enable them to work from home, and
    - The amount paid is no more than the deduction that the employee would have been entitled to for depreciation loss on the furniture or equipment (or the cost of the asset, in the case of low-value assets) for the income year in which the payment is made, but for the employment limitation.
40. The deduction that the employee would have been entitled to for an asset and, therefore, the amount that can be paid as exempt income, is dependent on the extent to which the employee uses the asset for their employment. This means that the amount that can be paid as exempt income will be equal to a proportion of the yearly depreciation loss on the asset (or a proportion of the cost of the asset in the case of a low-value asset).
41. Applying s CW 17, where there is evidence that an asset will be used exclusively for employment purposes, 100% of the yearly depreciation loss on the asset (or the total cost of the asset, in the case of a low-value asset) can be paid as exempt income of the employee. Further, under this Determination:
    - Where an employee who uses an asset principally (but not exclusively) for their employment, an amount of no more than 75%[4] of the yearly depreciation loss on the asset (or the cost of the asset, in the case of a low-value asset) can be paid as exempt income of the employee.

[2] Note that to the extent that an employee incurs a depreciation loss on existing furniture or equipment, this loss is included in the exempt income thresholds.

[3] Note that the threshold for low-value assets that were purchased before 17 March 2020 was $500. For assets purchased on or after 17 March 2020 and before 17 March 2021 the threshold was $5,000 and from 17 March 2021 the threshold was decreased to $1,000.

[4] In this context, the use of the words "no more than" indicates that it is up to the employer to determine the extent to which they are prepared to reimburse the employee for any amount of depreciation loss. But for those wishing to use this option, the exempt portion of any reimbursement can be no more than 75% of the applicable depreciation loss (and 25% where the item is used principally for private use).

- Where an employee uses an asset principally for private use, an amount of no more than 25% of the yearly depreciation loss on the asset (or the cost of the asset, in the case of a low-value asset) can be paid as exempt income of the employee.

42. The reimbursement option will require an employer to identify the cost of the asset for which the reimbursement is paid as well as determining whether the asset is being used exclusively or principally for employment purposes or whether the asset is being used principally for private purposes (so that they can calculate the appropriate proportion). For assets that are not low-value assets (which are likely to be uncommon), the employer will also need to apply the relevant depreciation rate to calculate the depreciation loss that would have been available to the employee.
43. It is acknowledged that the reimbursement option could be onerous in some cases, for instance, where an employer has many employees. That is why the safe harbour option has also been provided.
44. A written statement from an employee to their employer that the employee intends to use an asset for their employment, and whether principally or not, will be sufficient to establish such use. An email or expense claim application is sufficient to show the employee's intended use of the furniture or equipment.

This determination was signed by me on 25 August 2021.

Rob Falk

National Advisor, Technical Standards, Legal Services

Inland Revenue

FDR 2021/03: A type of attributing interest in a foreign investment fund for which a person may not use the fair dividend rate method (The Daintree Core Income Trust – New Zealand Dollar class of units)

Any investment by a New Zealand resident investor in the NZD class units of the Daintree Core Income Trust, to which none of the exemptions in section EX 29 to 43 of the Income Tax Act 2007 apply, is a type of attributing interest for which the investor may not use the fair dividend rate method to calculate foreign investment fund income from the interest.

Reference

This determination is made under section 91AAO(1)(b) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Technical Specialist - Network, under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Investments in the NZD class units of the Daintree Core Income Trust, an Australian Registered Managed Investment Scheme, are an attributing interest in a foreign investment fund ("FIF") for New Zealand resident investors when none of the exemptions in section EX 29 to EX 43 of the Income Tax Act 2007 apply.

The Fund is structured as an Australian Unit Trust and is a registered multi-class Managed Investment Scheme. Under section EX 32 of the Income Tax Act 2007 an exemption may arise for an Australian Unit Trust and a New Zealand resident investor so that a person's rights in the unit trust in an income year are not an attributing interest. The determination will only apply when an attributing interest arises.

New Zealand resident investors are required to apply the FIF rules to determine their tax liability in respect of their investment in shares in the Fund each year.

The Fund invests in a portfolio of global fixed interest securities and other financial arrangements. The Fund has on issue three types of unit class that provide holders of each class with an interest in the pool of investments held by the Fund. The NZD Unit Class of the Fund is a unit class denominated in New Zealand dollars. Foreign currency hedging arrangements are in place in relation to the NZD Unit Class of the Fund which effectively provide investors in this class with a New Zealand dollar denominated return on the financial arrangements held by the Fund.

The policy intention is that the FDR method of calculating FIF income should not be applied to investments that provide a New Zealand resident investor with a return similar to a New Zealand dollar denominated debt investment. It is appropriate for the Commissioner to take into account the whole of the arrangement in ascertaining whether an investment in a FIF provides the New Zealand-resident investor with a return akin to a New Zealand dollar denominated debt investment.

On this basis, where a New Zealand resident invests in the NZD Unit Class of the Fund, and holds an attributing interest in the FIF, I consider that it is appropriate for the investor holding that investment to be excluded from using the FDR method.

Scope of determination

This determination is issued on the basis of information provided to the Commissioner before the date of this determination and applies to an attributing interest in a FIF held by New Zealand resident investors in a non-resident issuer where:

1. The non-resident issuer:
   - Is an Australian Registered Managed Investment Scheme;
   - Is known at the date of this determination as the Daintree Core Income Trust; and
   - Is operated with separate classes of unit.
2. The attributing interest consists of the New Zealand dollar denominated units issued in the Daintree Core Income Fund, a class of units that provides an interest in the underlying assets of the fund that predominantly (i.e. 80% or more by value at a time in the income year) consist of financial arrangements such as international fixed interest securities; and
3. The investment interest attributable to the New Zealand dollar denominated class of shares are subject to currency hedging arrangements undertaken by the non-resident issuer for the purpose of eliminating exchange rate risk for New Zealand investors on a highly effective basis

Interpretation

In this determination, unless the context otherwise requires-

“Fair dividend rate method” means the fair dividend rate method under section YA 1 of the Income Tax Act 2007.

"Financial arrangement" means financial arrangement under section EW 3 of the Income Tax Act 2007.

“Foreign investment fund” means foreign investment fund under section YA 1 of the Income Tax Act 2007. and

"Non-resident" means a person that is not resident in New Zealand for the purposes of the Income Tax Act 2007.

Determination

An attributing interest in a FIF to which this determination applies is a type of attributing interest for which a person may not use the FDR method to calculate FIF income from the interest.

Application Date

This determination applies for the 2022 income year and subsequent income years.

However, under section 91AAO(3B) of the Tax Administration Act 1994, this determination does not apply for a person and an income year beginning before the date of the determination unless the person chooses that the determination applies for the income year.

Dated on this 10th day of September 2021

Greg Adamson

Technical Specialist Network

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 21/09: How to determine the cost price of bloodstock

Question

How is the cost price of bloodstock determined?

Answer

At the end of each year bloodstock must be valued at its cost price less any reduction applying for that year. Given this, when valuing bloodstock for tax purposes, the overarching principle is that, wherever possible, actual cost should be used as the basis of valuation. Where the actual cost is not known with certainty, such as with home-bred progeny, a consistent means of establishing the cost price of that progeny is still required. For home-bred progeny, the cost price should reflect the cost to the breeder of producing the foal.

Key terms

Bloodstock means a horse that is a member of the standardbred or thoroughbred breed of horses; and includes a share or interest in such a horse.[5]

Cost price means the cost associated with purchasing or producing bloodstock. All components of cost price are exclusive of GST.[6]

Reduction means the amount the cost price of the bloodstock is reduced by at the end of the income year, applicable to bloodstock aged 2 years or older that have been acquired for breeding.[7] This is also referred to as the "specified write down".

Explanation

1. This Question We've Been Asked outlines how to determine the cost price of bloodstock; including when progeny is home bred, when the stallion is owned by the taxpayer, and when a mare is purchased in-foal. It replaces the obsolete Public Information Bulletin (PIB) items *Bloodstock Cost Determination* in PIB 166 and PIB 175.

What this QWBA covers

2. This QWBA sets out how to determine the cost price of bloodstock in the following situations:
    - bloodstock that has been purchased – excluding in-foal mares
    - bloodstock that is home bred – including when the stallion used is owned by the breeder, or when the stallion or mare has been leased
    - bloodstock that has been purchased as an in-foal mare.
3. It also clarifies how unborn foals are to be treated at balance date.

[5] s YA 1 – definitions "bloodstock", Income Tax Act 2007.

[6] s YA 1 – definitions "cost price", Income Tax Act 2007.

[7] s EC 41, EC 42, EZ 5, or EZ 6, Income Tax Act 2007.

Background

4. Bloodstock, whether purchased or homebred, is initially required to be valued at its cost price.[8] In either case this will be the actual cost incurred in acquiring the animal. Where bloodstock is home-bred, the outlay or overheads incurred by the breeder in producing the progeny should be used to establish its cost price.[9]
5. It is worth noting that although some items of expenditure need to be attributed to the foal to ascertain its cost price, the expenditure remains deductible to the taxpayer where it meets the ordinary tests for deductibility.

Unborn foals at balance date

6. Unborn foals are not required to be valued at balance date.[10] This is so even where a mare is purchased by a breeder in-foal. See [13]-[23] for further discussion regarding the treatment of in-foal mares.

Purchased bloodstock – excluding in-foal mares

7. Bloodstock that is purchased should be valued at its acquisition cost plus the cost of getting the horse to its new location. This value may include items such as the acquisition cost, vet and valuation fees, transportation, and travel insurance.

Example

Example 1 – Purchased bloodstock

Henry is a breeder who purchases a 2 year old filly for $20,000. He pays $300 for transport and another $1,250 for vet and valuation fees. He also pays an additional $150 for travel insurance.

The total cost price of the filly is $21,700.

Home bred Progeny

8. Foals are valued at their cost price on the breeders' first balance date after they are born.[11] Any expenditure incurred in raising a foal after this first balance date is not required to be added to the cost price of the foal.
9. As servicing costs are incurred in the production of assessable income, they are fully deductible in the year in which the expenditure is incurred (as noted at [5]. This applies even if the foal dies either prior, or subsequent to its birth.
10. The cost price of all home bred progeny is made up of the following components:[12]
    - the stallion service fee paid, and
    - any reduction attributable to the mare in the year of foaling, and
    - any foaling, weaning (and vet fees incurred in rearing the foal) between the birth of the foal and the first balance date.

    Where a breeder employs external parties to undertake the foaling and weaning of progeny (as well as any associated veterinary needs), the cost of these activities is required to be attributed to the cost of the foal.

    Where the foaling and weaning of progeny is undertaken by the breeder personally or the breeder's employees, the cost (or a reasonable estimation of the cost) to the breeding business of these activities should be attributed to the cost of the foal.

    Where external parties are not employed, it is acknowledged that in some cases, arriving at the exact cost to the breeder of these activities (or even a reasonable estimate of that cost) may be difficult. In view of this, the Commissioner will accept a *de minimis* amount of $500 to be used as an acceptable approximation of these foaling and weaning expenses (vet fees will invariably be charged by an external party and are therefore not included in this *de minimis* figure).

Stallion owned by breeder

11. Where the stallion is owned by the breeder the service fee component of a foal's cost can be calculated in one of the

[8] ss EC 39(3) and EC 44, Income Tax Act 2007.

[9] TRA *Case S12* (1995) 17 NZTC 7,102.

[10] This replaces advice previously given in Public Information Bulletin 175, July 1998 (at page 8).

[11] s EC 44, Income Tax Act 2007.

[12] TRA *Case S12* (1995) 17 NZTC 7,102.

following two ways (the breeder can choose which option best suits them):

- the service fee usually charged by the breeder to an arms-length party (this represents the "economic cost" of the service to the breeder, being the service fee forgone to service their own stock), or
- $\frac{\text{the direct costs of the stallion in the year of service}}{\text{the number of mares serviced}}$

where the direct costs are an accumulation of insurance, external service costs (such as vet fees), and the stallion's reduction in the year of service.

Leased bloodstock

12. If a mare has been leased, there will be no reduction available to the breeder leasing that bloodstock that could be attributed to the cost of any progeny. In this circumstance, the cost price of the progeny must, instead, include any lease fee paid in the year of foaling.
13. If a breeder that is leasing a stallion wishes to use the **direct costs** formula at [11], that breeder will need to include all lease payments made in the year of service as part of **the direct costs of the stallion in the year of service** in the calculation. This expense replaces the reduction of the stallion in the year of service in the calculation.

Examples

Example 2 – Homebred progeny, service fee paid for use of stallion

Margaret pays a service fee of $12,500 to have one of her mares serviced. At the time the foal is born the mare's cost price is $18,000 and the mare is 5 years old. A foaling fee of $400, a $350 weaning fee and vet fees of $400 are also incurred during the year.

The cost price of the foal is as follows:

$12,500	stallion service fee
$4,500	reduction on mare in year of foaling[13]
$750	foaling and weaning fees
$400	vet fee
$18,150	total cost price

Example 3 – Homebred progeny, stallion owned by breeder

Hamish is a breeder who owns a 6-year old stallion; the service fee he usually charges is $4,000. Hamish decides to service three of his mares with the stallion, which also serviced 12 mares from third parties. The stallion's vet fees for the year come to $300 and his insurance is $2,700, the reduction available in that year is $0 (the stallion has already been fully reduced and has a closing value of $1, so there is no reduction in the year of service).

Market value

Per [11], if Hamish chooses the first option, the service fee component of any resulting foals would be $4,000.

Direct cost

Using the second option, the service fee component would be:

$$\frac{\text{vet fees + insurance + reduction in year of service (\$300 + \$2,700 + \$0 = \$3,000)}}{\text{number of mares serviced (15)}}$$

The service fee component of any resulting foals would be $200.

[13] s EC 42, Income Tax Act 2007

Example 4 – Home bred progeny, mare leased

Thorough Stud Limited leases a mare. For the year of foaling the mare's lease fee payments amount to $7,200. Thorough Stud Limited also pays a stallion service fee of $6,000. Up until the first balance date, the vet and foaling fees were incurred totalling $1,200.

The cost price of the foal is as follows:

$6,000	stallion service fee
$7,200	mare's lease fee
$1,200	foaling and vet fees
$14,400	total cost price of the foal

The purchase of in-foal mares

14. The usual gestation period for a foal is a little over 11 months. It is therefore likely that a mare purchased in-foal will still be in-foal on the first balance date with the new owner. This being so, for mares purchased in-foal there needs to be two ways of determining the cost price, dependent on whether the foal is born before the first or second balance date of the new owner.
15. Irrespective of the year in which the foal is born, on the first balance date after its birth it is required to be valued in the manner described at [10].

Service fee component of a mare purchased in-foal

16. As previously discussed, one of the components of a foal's cost is the stallion service fee. Where the mare has been purchased in-foal, the service fee would have been paid by the mare's previous owner. Generally, the details of this service fee (or the usual service fee charged by the stallion owner) should be easily obtainable. This service fee will make up a part of the total purchase price of the mare but will need to be separated out at the time the cost price of the foal is determined. This is on the basis that the service fee component of the mare's purchase price is the amount of the premium paid for the unborn foal (or at least a reasonable proxy for that premium).
17. In the unlikely event that the service fee component is not able to be ascertained, the Commissioner will accept an apportionment of the acquisition price between the mare and the foal, based on the recommendation of a recognised bloodstock valuer.
18. If the amount of the service fee is the same or more than the total acquisition price[14] of the in-foal mare, then the mare should be valued at $1, (the lowest value possible under current legislation).[15] The remainder of the acquisition price will be attributed to the foal's cost price. This recognises the reality that, in this circumstance, the price paid was to acquire the foal and not the mare.

Foal born in year 1

19. If the foal is born before the first balance date of the new owner, the service fee component of the acquisition price for the mare would be allocated to the foal. The service fee is deducted from the acquisition price of the mare before applying any reduction to the mare's cost price for that year.
20. The foal's cost price will be determined using the method already discussed in [10] and Example 2.

Foal born in year 2

21. If the mare is still in-foal at the new owners' first balance date, the cost price of the mare still needs to be established. In this scenario this would be the total acquisition cost of the mare. The reduction applicable to the mare in that year would then be applied to this total acquisition price.
22. In the second year of ownership, if no live foal results from the pregnancy, the mare will remain valued at this written down amount and the year two reduction applied to it.
23. When the foal is born in the second year, a cost price will need to be determined for both the mare and the foal at the

[14] Inclusive of any costs associated in acquiring the mare, per [7].

[15] s EC 45, Income Tax Act 2007.

breeder's balance date for that year. To do this, the service fee component needs to be removed from the mare and attributed to the foal. This lowers the mare's value (by the amount attributed to the foal). The year two reduction to the mare can then be applied to this resulting lowered value.

24. The foal's cost price will be comprised of this service fee component, the year two reduction on the mare and any foaling, weaning and vet fees incurred (as discussed at [10] and Example 2).

Example

Example 5 - Mare purchased in-foal

A 4 year old mare was purchased in-foal for $20,000 – this includes transportation and insurance. The service fee paid for the mare by the previous owner was $5,000.

Scenario A - Mare foals in year 1 (before the first balance date of the new owner)

Mare:

Cost price: $20,000 less the service fee of $5,000 – which is attributed to the cost price of the foal = $15,000

Reduction: cost price of mare ÷ (9 – age of mare)

$15,000 divided by (9-4) = $3,000

Closing value: (cost price – reduction) = $12,000

Foal:

Cost price (closing value): $3,000 (reduction from mare) +$5,000 (service fee) +$1,000 (foaling and weaning fees) +$500 (vet fees) = $9,500.

Scenario B - Mare foals in year 2 (after first balance date of the new owner)

Year 1

Mare:

Cost price: $20,000

Reduction: cost price of mare ÷ (9 – age of mare)

$20,000 divided by (9-4) = $4000

Closing value (cost price – reduction) = $16,000

Year 2

Mare:

Opening value in year 2 (from closing value in year 1): $16,000 less the service fee of $5,000 (which is attributed to the cost price of the foal) = $11,000

Reduction: Opening value of mare (less service fee reduction) ÷ (9 – age of mare)

$11,000 ÷ (9 – 5) = $2750

Closing value: (cost price – reduction) = $8,250

Foal:

Cost price (closing value): $2,750 (year 2 reduction from mare) + $5,000 (service fee) + $1,000 (foaling and weaning fees) + $500 (vet fees) = $9,250.

References

Legislative References

Income Tax Act 2007, ss EC 41, EC 42, EC 45, YA 1 "bloodstock" and "cost price".

Case References

TRA Case S12 (1995) 17 NZTC 7,102

QB 21/10: If I run a hotel, motel or boarding house and live on site, what expenditure can I claim?

Question

If I run a hotel, motel or boarding house and live on site, what expenditure can I claim?

Answer

If you have a business of providing accommodation through a hotel, motel, boarding house, or other business premises, and live on-site, any expenses you incur relating solely to the running of your business are fully deductible. However, expenses relating to your private quarters or family life are not deductible. This is because you cannot claim a deduction for expenses that are private or domestic in nature.

If the expenses relate to both your private quarters and your business, you can claim a deduction to the extent that the expenses relate to the running of your business. This requires you to calculate the portion of these mixed expenses that are attributable to your business.

Key terms

Mixed expenses means expenses that relate to both your business and other purposes, such as private or domestic purposes.

Mixed-use areas means areas of your premises used for both business and other purposes.

Proprietor means a self-employed owner or operator of a motel, hotel, boarding house or other business premises used to provide accommodation to guests.

Private quarters means a section of the business premises set aside or used for domestic activities by the Proprietor and the Proprietor's family.

Explanation

1. This item applies to self-employed proprietors of hotels, motels, boarding houses, or any other businesses that provide accommodation through business premises. If you provide short-term accommodation in your own home or a private dwelling through a platform such as Airbnb or Bookabach, see QB 19/05 to QB 19/09. This item supplements those items on short-term accommodation where the accommodation is provided in business premises.
2. This item explains how to apportion expenditure that is incurred for both business and private purposes.
3. This item updates and replaces "Adjustment to costs when domestic establishment attached to business premises", *Tax Information Bulletin* Vol 5, No 11 (April 1994): 9. This item applies from the 2021/22 income year.
4. This item does not apply to accommodation providers that operate as companies or through other separate legal entities. This is because the law applies to these entities differently.

What expenses can I claim?

5. Expenses you incur are deductible from your income to the extent that you incur them in carrying on your business.[16] However, deductibility is subject to some limitations.[17] If one of these limitations applies to your expenses, a deduction will not be available to the extent the limitation applies.
6. One of these limitations is the private limitation.[18] The private limitation applies if you incur expenses that relate solely to your household, family unit, or personal life. You can't claim a deduction for these private expenses because of the private limitation.

[16] Section DA 1.
[17] Section DA 2.
[18] Section DA 2(2).

7. This means that if an expense relates solely to your business, you can claim all of the expense in your income tax return provided none of the other general limitations apply, such as the capital limitation. You can also claim for the depreciation of capital assets used in your business. For more information on depreciation, see [21].
8. If you are self-employed and you have employed a manager or other person that lives on site, expenses incurred on their private quarters are fully deductible, as these are incurred in carrying on your business.
9. If you personally live on site, then you will likely incur expenses that relate to both your business and your private quarters. This item refers to these expenses as "mixed expenses". Mixed expenses are deductible to the extent they relate to your business. This item outlines how to apportion your mixed expenses between business and private purposes.

How do I apportion mixed expenses?

10. The first step in working out what you can claim in your income tax return is to separate mixed expenses from expenses incurred solely for business purposes (for which you can claim 100%) and expenses incurred solely for private purposes (for which you can't claim anything).
11. *Table 1 – Examples of types of expenditure* lists some examples of expenses you might incur and what you can claim for them.

Table 1 – Examples of types of expenditure

Business expenses (fully deductible)	Private expenses (not deductible)	Mixed expenses (partially deductible)
Advertising costs; Any commission or fee you pay to an advertising platform or transaction facilitator (this does not include any service fee the guests pay the platform – just fees you pay); Business insurance; Telephone and internet expenses if you have a separate internet connection for business use and guests; Supplies used exclusively by guests.	Groceries used by your and your family; Petrol, insurance, and maintenance for a personal car; House or contents insurance if you have a separate policy for your private quarters.	Power bills; Telephone and internet expenses if you don't have a separate internet connection for guests; Interest on your mortgage; Rates; Rent you pay for the use of the premises; Repairs and maintenance that cannot be attributed to wholly business or private areas.

12. Some mixed expenses can be separated out or dissected where these expenses have distinct, severable parts, such as an itemised invoice or bill. For example, if you have multiple phone plans through the same provider, you can dissect the part of your phone bill that relates to the business line if the bill itemises these expenses.
13. Once you've separated mixed expenses that can't be dissected from those that relate solely to your business or private use, the next step is to calculate what portion of those mixed expenses relates to your business. This is called apportionment.
14. The method you use to apportion expenses needs to be fair and reasonable. Where building expenses are being split between business and private use, the courts have usually apportioned these on a space and time basis.[19] This means working out the floor area of the building that is used for business purposes, private purposes and mixed-use. You may then need to apportion the mixed-use areas based on the amount of time they are used for business and private purposes. Apportioning expenses is not an exact science, but the figure you reach must be fair and reasonable,[20] and based on evidence that a particular part of the expense is deductible.[21]
15. Generally, using a space and time calculation will be appropriate for calculating the business use of certain areas of your premises. The first step is to work out the floor area of your premises used exclusively by your guests or for business purposes as a proportion of the total area of your premises. If 160m^2 of your premises is used solely for business purposes, and the total size of your premises is 200m^2, then you can claim 80% of your mixed expenses in your return. As these areas are used solely for business purposes, you don't need to make any adjustment for time.

[19] *CIR v Banks* [1978] 2 NZLR 472 (CA).
[20] *Ronpibon Tin NL v FC of T* (1949) 8 ATD 432 (HCA).
[21] *Buckley & Young Ltd v CIR* 1978] 2 NZLR 485 (CA).

16. In addition, if you have mixed-use areas in your premises, you can claim a deduction for these spaces based on the portion of time those areas are used for business purposes. You need to work out how much time on average the mixed-use area is used for business purposes. In general, Inland Revenue will accept 50% as a baseline for the amount of time mixed-use areas are used for business purposes where there is about equal business and private use, or where the business and private uses are too intertwined to measure each separately. If the area is not often used for business purposes, then the business use is likely to be less than 50%. Examples 1 and 3 show how these calculations might look in practice.
17. If another method is easier or more accurate in your circumstances, you may use that method instead. Regardless of the method you use, the same principles of apportionment should apply:
    - separate out expenses that relate solely to your business or solely to private purposes; then
    - apportion mixed expenses by identifying which part of the expenses relate to your business.
18. You must keep records to support the method you use for apportionment (for example, calculations of floor area, estimates of business and private use and evidence of asset valuations).
19. Once you've worked out what percentage of mixed expenses you can claim, you may continue to use this figure for future income years unless your circumstances change.

Example 1 – Apportioning deductible expenses when proprietor lives on one floor of hotel building

Te Ahurei is a self-employed operator of a small hotel and restaurant. Te Ahurei needs to work out her business expenses for the 2022 income year. She has carefully kept her private expenses such as groceries and petrol for her family car out of the business. Without these expenses, Te Ahurei still incurred $700,000 of business expenses for the 2022 income year. By identifying those expenses that were wholly for her business, Te Ahurei works out that $600,000 is fully deductible in her return. She then needs to calculate how much of the remaining $100,000 on mixed expenses (such as power, internet and mortgage interest) she can claim. Her first step is to calculate which areas of her hotel are for business, private, or mixed purposes.

The hotel has five floors. The ground floor operates as a bar, restaurant and reception. The first, second, and third floors contain the guest rooms of the hotel. The fourth floor is occupied by Te Ahurei and her family as a residence, but Te Ahurei also uses some areas in the residence to help with the running of the hotel – there is a large, purpose-built laundry equipped with industrial washing machines which are used for washing guest linen daily. Although Te Ahurei uses the laundry for family laundry as well, it is a purpose-built business area and the private use is too small to be reasonably calculated.

The dining area is regularly used for meeting with staff, bookkeeping, managing bookings, and taking calls after hours. The floor areas of the top floor of Te Ahurei's premises are shown in the diagram below:

Te Ahurei must calculate what proportion of her mixed expenses she may deduct for the areas of the house used exclusively for business and what proportion she may deduct for mixed-use areas.

As four of the floors in the building are used exclusively for business purposes, Te Ahurei can claim 80% of her mixed expenses by default. This figure is calculated by dividing the portion of the premises used exclusively for business purposes by the total area of premises, and then multiplying this figure by 100 to get a percentage. In this case, as the floors are equal size, the number of floors could be used rather than the floor area in square metres (m^2):

$$\frac{4}{5} \times 100 = 80\%$$

As Te Ahurei's mixed expenses totalled $100,000, she can claim 80% of this ($80,000) in her return as it relates to the 4 floors used for business purposes. She apportions the remaining $20,000 of her mixed expenses to see if she can deduct any further amount.

Te Ahurei's private quarters can then be separated out:

$150m^2$	Private areas – 0% deductible
$20m^2$	Mixed-use areas – partially deductible
$30m^2$	Business areas – 100% deductible

First, Te Ahurei calculates the proportion of her mixed expenses that relate to the laundry that will be deductible. The laundry is $30m^2$ out of the total floor area of her private premises of $200m^2$.

$$\text{Deductible portion of mixed expenses for laundry} = \frac{30}{200} \times \$20{,}000 = \$3{,}000$$

Te Ahurei then calculates what proportion of her mixed expenses she can claim for the mixed-use areas. She decides to use the well-accepted space and time method.

The only mixed-use area is the dining room of $20m^2$. From a time perspective, the dining room is used about equally for business and private use given the daily staff meetings and so Te Ahurei considers that 50% business use is appropriate. The apportionment for the dining room is as follows:

$$\text{Deductible portion of mixed expenses for dining room} = \frac{20}{200} \times 50\% \times \$20{,}000$$

$$\text{Deductible portion of mixed expenses for dining room} = \$1{,}000$$

This means Te Ahurei can claim $4,000 (being $3,000 + $1,000) of the mixed expenditure for her private premises. Adding this figure to the $80,000 figure for the other 4 floors, the total amount Te Ahurei can claim for her mixed expenses is $84,000 (84%). This is in addition to her business expenses of $600,000.

Can I apportion certain expenses differently?

20. As stated at [14], it will generally be appropriate to use a space and time method for apportioning expenses that relate to your whole premises. The approach in this item can also apply to individual items of expenditure where a different apportionment is appropriate. For instance, if you have evidence to support a different, more accurate, way of calculating business use for a certain expense, this can be used instead. This is illustrated in Example 2.

Example 2 – Apportionment of power expenses

Using the same facts as Example 1, Te Ahurei breaks down her power bills for the 2022 year. She discovers using electricity usage monitors that despite her private premises taking up nearly 20% of the floor area of her business premises, the restaurant and hotel areas, and industrial washing machines, are responsible for around 95% of her power use. As power bills are usually calculated based on use, Te Ahurei could apportion her power bill based on usage, rather than space and time.

In the previous example, Te Ahurei determined that Inland Revenue will accept that 84% of her mixed expenses are attributable to business use and deductible. If Te Ahurei has evidence showing the breakdown of her power bills, Inland Revenue will accept a deduction for 95% of her power expenses for the 2022 year. Te Ahurei must record details from the electricity usage monitors, and/or retain other records of the breakdown of power usage.

What about depreciation?

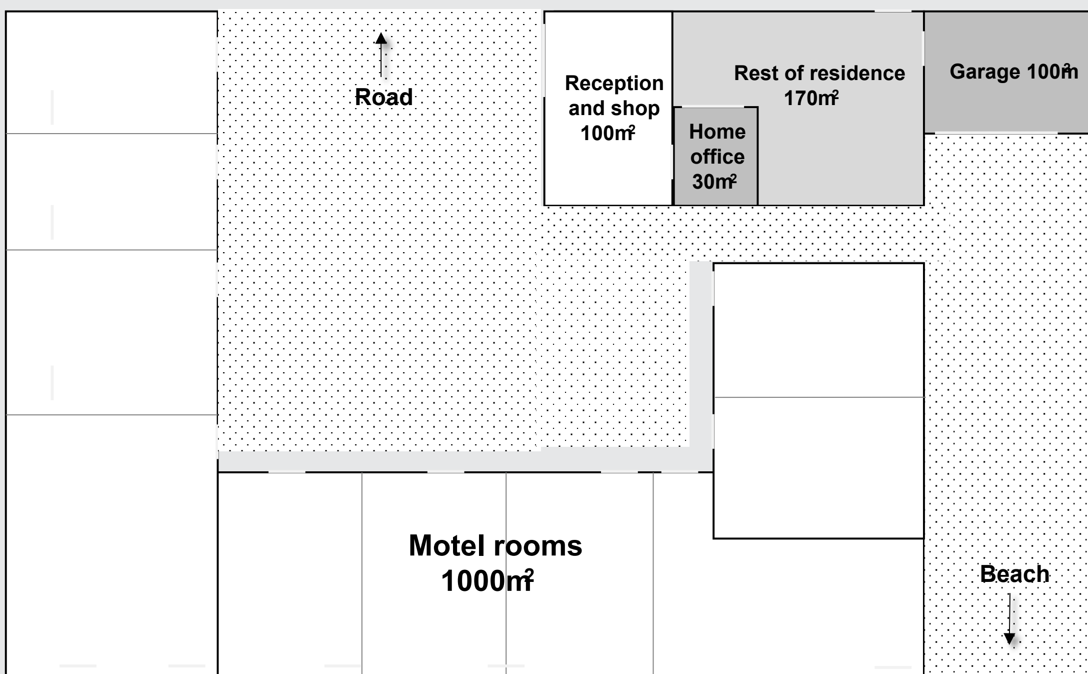
21. You can also claim deductions for the depreciation of chattels in your home that are used for your business. You will need to make an adjustment for business use of private assets. See the Inland Revenue website using search term: *depreciation* for more information on depreciation methods and rates. The Inland Revenue guide IR260 *Depreciation – a guide for business* contains a section on adjustments for business use and examples of how to calculate the apportionment between business and private use for depreciation purposes.

Example 3 – Apportioning expenses for motel with multiple buildings

Baticul Lodge is a beach-front motel. The self-employed owners and operators of the motel, Luke and Asch, incurred $500,000 of business expenses for the 2022 income year. These expenses are 100% deductible. Luke and Asch need to work out how much they can claim for their mixed expenses of $75,000. Their purely private expenses are not included as they can't be deducted.

The two buildings on the motel premises have a total area of 1,400m^2. One building is the main motel building, which contains 10 units for use by guests. The second building opens to a reception area and small shop for groceries and outdoor accessories. Luke and Asch live behind this reception area in a two-bedroom unit, with a home office in the front. The reception building is also attached to a large garage which is used to house the family vehicle and to store kayaks, boogie boards, life jackets and fishing equipment for guests.

The following plan shows the areas used for business, private and mixed use:



Luke and Asch need to work out how much they can claim for their mixed expenses in relation to these mixed-use areas.

170m²	Private areas – 0% deductible
130m²	Mixed-use areas – partially deductible
1100m²	Business areas – 100% deductible

Of the 1,400m² area, 1,100m² (78.6%) is exclusively for business purposes. Therefore, Luke and Asch can deduct $58,950 of their $75,000 mixed expenses in relation to the business areas.

$$\text{Business portion of mixed expenses} = \frac{1,100}{1,400} \times \$75,000 = \$58,950$$

The home office is used as the main hub for the administrative work for the motel. This area is used exclusively for business purposes by either Luke, Asch or their employees during regular office hours, and is also frequently used by Luke and Asch at other times for general administration and management of the motel. The computer in this home office is also Luke's personal computer, and the office is sometimes used in the evenings or mornings in a personal capacity. They work out that the home office is used for business purposes approximately 80% of the time. This means that Luke and Asch can deduct 80% of their mixed expenses in relation to the home office area.

The home office can be calculated on a space and time basis using the floor area of the home office, which is 30m², and 80% for the time it is used for business purposes:

$$\text{Business portion of home office expenses} = \frac{30}{1,400} \times 80\% = 1.7\%$$

Luke and Asch can claim 1.7% of their total mixed expenses in relation to the home office, which is $75,000 x 1.7% = $1,275.

The other mixed-use area, the garage, is used roughly equally for both business and private purposes, so Luke and Asch will use the default figure of 50% for the time factor for these expenses. The garage is 100m² so apportionment of the garage is calculated as:

$$\text{Business portion of garage expenses} = \frac{100}{1,400} \times 50\% = 3.6\%$$

This means they can claim 3.6% of their mixed expenses in relation to the garage, which is $75,000 x 3.6% = $2,700.

Adding all these figures together, Luke and Asch work out that the total they can claim for their mixed expenses for the 2022 income year is $62,925 (83.9%):

$$\$58,950 + 2,700 + 1,275 = \$62,925$$

They can claim this in addition to their business expenses of $500,000.

Example 4 – Apportionment in boarding house

Elanor operates a 10-bedroom boarding house that she also lives in. Elanor uses one of the bedrooms exclusively as her personal room. The 9 other bedrooms are occupied by long-term tenants. Every other room in the house is accessible and used by both Elanor and the other tenants in the house, including the living room, kitchen, and bathrooms. The total size of the house is 350m², with Elanor's room taking up 30m².

The 9 other bedrooms take up 180m². The remaining 140m² is mixed-use areas as they are used by both Elanor for private purposes and by other tenants, which is business use.

30m²	Private areas – 0% deductible
140m²	Mixed-use areas – partially deductible
180m²	Business areas – 100% deductible

Elanor carefully ensures that none of her private expenses are included in her expenses relating to the boarding house. Her total business expenses for the 2022 year are $60,000. Of that sum, $35,000 relates solely to expenses relating to the guests, and $25,000 relates to mixed expenses. The $35,000 of expenses that relate solely to guests is fully deductible.

Apportioning the mixed expenses by space

The $25,000 of mixed expenses first need to be apportioned on a space basis.

Elanor can claim 100% of her mixed expenses for the other 9 bedrooms and cannot claim anything in relation to her bedroom.

$$\text{Fully deductible portion of mixed expenses} = \frac{180}{350} = 51.4\% \times \$25{,}000 = \$12{,}857.13$$

$$\text{Non-deductible portion of mixed expenses} = \frac{100}{1{,}400} = 8.6\% \times \$25{,}000 = \$2{,}142.87$$

$$\text{Partially deductible portion of mixed expenses} = \frac{140}{350} = 40\% \times \$25{,}000 = \$10{,}000$$

Fully deductible portion of mixed expenses	12,857.13
Non-deductible portion of mixed expenses	2,142.87
Partially deductible portion of mixed expenses	10,000.00
Total mixed expenses	25,000.00

Apportioning the partially deductible expenses by time

Elanor notes that the common areas, and expenses relating to these common areas, are used primarily by the other tenants. Elanor considers that she can claim 90% in relation to the common areas, as they are used 90% of the time by the other 9 tenants and only 10% of the time by Elanor. This is how Elanor calculates what she can claim for her mixed expenses:

Business portion of partially deductible expenses = 90% x $10,000 = $9,000

Elanor can claim this in addition to the amounts she can claim for the $12,857.13 in relation to the bedrooms, meaning the total amount she can claim is $21,857.13 for the 2022 income year:

Deductible amount of mixed expenses = $12,857.13 + $9,000 = $21,857.13

Even if some of the other rooms are not occupied by tenants for part of the year, these rooms are not used at all by Elanor for anything but business purposes, so she can continue to claim 100% of her expenses for these bedrooms. If Elanor began using one of the rooms as an office or for storage when it is not occupied, or if Elanor had a family member stay with her in one of the rooms, she would need to make an adjustment for the private use of these areas.

References

Legislative references

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Case references

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Inland Revenue, *Depreciation: A guide for business* (IR260, November 2020). **ird.govt.nz/income-tax/income-tax-for-businesses-and-organisations/types-of-business-expenses/depreciation**

QB 19/05 – What are my income tax obligations if I rent out my home or a separate dwelling on my property as short-stay accommodation? **taxtechnical.ird.govt.nz/en/questions-we-ve-been-asked/2019/download-qb19-05**

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