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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.

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Your opportunity to comment

Ref	Draft type	Title	Comment deadline
ED0243	Operational statement	When employee allowances for additional transport costs are exempt from tax	22 July 2022
PUB00396	Interpretation statement	Cash basis persons under the financial arrangements rules	15 July 2022

IN SUMMARY

New legislation

Order in Council - Taxation (Use of Money Interest Rates) Amendment Regulations 2022 3
These regulations, which came into force on 10 May 2022, amend the Taxation (Use of Money Interest Rates) Regulations 1998 to increase the taxpayer's paying rate of interest on unpaid tax from 7.00% to 7.28% per annum. The Commissioner of Inland Revenue's paying rate of interest on overpaid tax remains unchanged at 0.00% per annum. These rates have been determined in accordance with the Taxation (Use of Money Interest Rates Setting Process) Regulations 1997.

Order in Council - Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations 2022 3
These regulations, which came into force on 1 July 2022, amend the Income Tax (Fringe Benefit Tax, Interest on Loans) Regulations 1995.

These regulations increase the rate of interest that applies for fringe benefit tax purposes to employment-related loans from 4.50% to 4.78%. The new rate applies for the quarter beginning 1 July 2022 and for subsequent quarters.

Order in Council - Income Tax (Deemed rate of return on attributing interests in Foreign Investment Funds, 2021–22 income year) Order 2022 4
This order sets the deemed rate of return used to calculate foreign investment fund income for the 2021–22 income year under the deemed rate of return calculation method set out in section EX 55 of the Income Tax Act 2007.

The order sets the deemed rate of return for the 2021–22 income year at 6.01%. The deemed rate of return set for the 2020–21 income year was 4.43%.

Determination

NAMV 2022: National Average Market Values of Specified Livestock Determination 5
This determination establishes the national average market values (NAMV) of specified livestock for 2022.

Rulings

BR Pub 22/06: FBT - Charitable and Other Donee Organisations and Fringe Benefit Tax 8
This ruling considers when benefits provided by charitable organisations to their employees may be excluded from being treated as fringe benefits.

BR Pub 22/07: Goods and Services Tax – Importers and input tax deductions 25
This public ruling explains when an importer who accounts for GST on an invoice basis can claim an input tax deduction on GST collected by the New Zealand Customs Service. It also explains what documentation importers can use as an invoice to support the input tax deduction and associated record-keeping requirements.

BR Pub 06/03: Withdrawal notice 33
BR Pub 06/03 applies up to and including 8 July 2022. It is replaced by BR Pub 22/07 which takes effect from 9 July 2022.

Questions we've been asked

QB 22/03: GST – Customs brokers and GST levied by Customs 34
This question we've been asked clarifies how customs brokers should treat the GST they pay to the New Zealand Customs Service on behalf of their importer clients.

QB 22/04: GST – Importers and recalculated GST 37
This question we've been asked clarifies when importers can claim input tax deductions where GST is overpaid to the New Zealand Customs Service.

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Operational statement

OS 19/04 (KM 2022): Kilometre rates for the business use of vehicles for the 2022 income year 39
The table of rates for the 2021/2022 income year for motor vehicle expenditure claims.

Technical decision summaries

TDS 22/05: Whether weathertightness payments by the Crown are subject to GST 40
Goods and services tax – grants and subsidies.

TDS 22/07: Income tax, controlled foreign company, double tax agreement, shortfall penalties 45
Income tax: income under ordinary concepts, employment income, attributed controlled foreign company income; Double tax agreement: tax residency, dependent personal services; Tax Administration Act: shortfall penalties.

NEW LEGISLATION

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

Order in Council - Taxation (Use of Money Interest Rates) Amendment Regulations 2022

Sections 120E(1) and 120H of the Tax Administration Act 1994

The use of money interest (UOMI) rate on underpayments of taxes and duties has changed in line with market interest rates. The new underpayment rate is 7.28% (previously 7.00%). The overpayment rate remains at 0%.

Background

The UOMI underpayment rate is charged to taxpayers on underpayments of tax to Inland Revenue, while the UOMI overpayment rate is paid to taxpayers on money paid to Inland Revenue exceeding their tax liability.

Section 120H(1)(b) of the Tax Administration Act 1994 permits the making of regulations by Order in Council to set the UOMI underpayment and overpayment rates. Once a rate is set, it remains at that rate until changed by a subsequent Order in Council.

The UOMI underpayment rate is based on the 'floating first mortgage new customer housing rate' series published by the Reserve Bank (RBNZ) each month, while the UOMI overpayment rate is based on RBNZ's '90-day bank bill rate' series each month. The UOMI rates are both adjusted if either the RBNZ 90-day bank bill rate or the floating first mortgage new customer housing rate moves by 1% or more, or if one of these indexes moves by 0.2% or more and the UOMI rates have not been adjusted in the last 12 months.

The UOMI rates are reviewed regularly to ensure they are in line with market interest rates. The new UOMI underpayment rate and existing UOMI overpayment rate are consistent with the floating first mortgage new customer housing rate and the 90-day bank bill rate.

Effective date

The new UOMI underpayment rate applies on and after 10 May 2022.

Order in Council - Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations 2022

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

The fringe benefit tax (FBT) prescribed rate of interest for low-interest employment-related loans has been increased from 4.50% to 4.78%.

Background

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

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

By administrative convention, the FBT prescribed rate of interest is based on the 'floating first mortgage new customer housing rate' series published by the Reserve Bank (RBNZ) each month. It is updated when there has been an increase or decrease in the

RBNZ rate of 20 or more basis points since the FBT rate was last set. The RBNZ rate for December 2021 was 4.78%. This is up from 4.50%, the rate for March 2020, when the FBT prescribed rate of interest was last set. The FBT prescribed rate of interest is being lifted accordingly.

Effective date

The new prescribed rate of 4.78% applies for the quarter beginning 1 July 2022 and subsequent quarters.

Order in Council - Income Tax (Deemed rate of return on Attributing Interests in Foreign Investment Funds, 2021-22 income year) Order 2022

Section EX 55(4)(b) and (6)(c) of the Income Tax Act 2007

The deemed rate of return for taxing interests in foreign investment funds is 6.01% for the 2021–22 income year, up from 4.43% for the previous income year.

Background

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

Effective date

The new rate was set by Order in Council on 23 May 2022 and came into force on 27 May 2022.

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.

National Average Market Values of Specified Livestock Determination 2022

Note to this determination

This note does not form part of the national average market values of specified livestock determination 2022 (the determination) but is produced to aid Inland Revenue staff, taxpayers and their agents in their understanding of how the values contained in this determination are arrived at and how they should be used.

Section EC 15 of the Income Tax Act 2007 (the Act) requires the Commissioner of Inland Revenue (the Commissioner) to make a determination declaring the national average market values (NAMV) for an income year for each class of specified livestock set out in Schedule 17 of the Act. The determination is published in May each year.

These NAMVs are used by taxpayers that are in the business of livestock farming to value their livestock on hand, where the taxpayer has elected to use the herd scheme to value livestock in the income year.

As the name of this determination suggests, NAMVs provide the **national** average market value for the specified livestock classes. As such they may not always reflect the market value of the livestock of a particular taxpayer, or even of a particular region. This being so, the values are not intended to be used for any other purpose than that for which they are produced; valuing livestock of taxpayers who have elected to value their livestock under the herd scheme in the income year for which the determination relates.

To ascertain the national average **market value** of the various classes of livestock the Commissioner contracts with experienced livestock valuers situated throughout the country[1]. Each valuer is asked to provide the market value of the various specified livestock classes located in a specified region. There is generally more than one valuer contracted for each region. The market valuations required are for "good quality on-farm animals (capital stock)" on 30th April.

From these values the CIR then calculates the **national average** market value for each livestock class. In the case of sheep, beef, dairy cattle and deer (red, wapiti and elk) classes a weighted average is used against the values produced by each valuer (based on total livestock numbers for a type of livestock in that region compared to the national herd numbers for that type of livestock[2]). Because of their comparatively low numbers, a straight average is used for the remaining livestock types (except "other deer"). The value of "other deer" is taken as the mid-point between trophy and meat market values.

National Average Market Values of Specified Livestock Determination 2022

This determination may be cited as "The National Average Market Values of Specified Livestock Determination, 2022".

This determination is made in terms of section EC 15 of the Income Tax Act 2007 and shall apply to specified livestock on hand at the end of the 2021-2022 income year.

For the purposes of section EC 15 of the Income Tax Act 2007 the national average market values of specified livestock, for the 2021-2022 income year, are as set out in the following table.

[1] Thirty-eight valuations were obtained for the 2022 determination.

[2] Numbers are based on data collated by Statistics New Zealand.

National Average Market Values of Specified Livestock

Type of Livestock	Classes of Livestock	Average Market Value per Head ($)
Sheep	Ewe hoggets	143.00
	Ram and wether hoggets	143.00
	Two-tooth ewes	224.00
	Mixed-age ewes (rising three-year and four-year old ewes)	202.00
	Rising five-year and older ewes	176.00
	Mixed-age wethers	147.00
	Breeding rams	384.00
Beef cattle	*Beef breeds and beef crosses:*	
	Rising one-year heifers	665.00
	Rising two-year heifers	1038.00
	Mixed-age cows	1328.00
	Rising one-year steers and bulls	808.00
	Rising two-year steers and bulls	1242.00
	Rising three-year and older steers and bulls	1587.00
	Breeding bulls	3158.00
Dairy cattle	*Friesian and related breeds, Jersey and other dairy breeds:*	
	Rising one-year heifers	809.00
	Rising two-year heifers	1472.00
	Mixed-age cows	1697.00
	Rising one-year steers and bulls	476.00
	Rising two-year steers and bulls	894.00
	Rising three-year and older steers and bulls	1233.00
	Breeding bulls	1759.00
Deer	*Red deer, wapiti, elk, and related crossbreeds:*	
	Rising one-year hinds	189.00
	Rising two-year hinds	355.00
	Mixed-age hinds	379.00
	Rising one-year stags	242.00
	Rising two-year and older stags (non-breeding)	475.00
	Breeding stags	2131.00
	Other breeds:	
	Rising one-year hinds	100.00
	Rising two-year hinds	159.00
	Mixed-age hinds	191.00

	Rising one-year stags	136.00
	Rising two-year and older stags (non-breeding)	226.00
	Breeding stags	649.00
Goats	*Angora and angora crosses (mohair producing):*	
	Rising one-year does	110.00
	Mixed-age does	148.00
	Rising one-year bucks (non-breeding)/wethers	91.00
	Bucks (non-breeding)/wethers over one year	101.00
	Breeding bucks	427.00
	Other fibre and meat producing goats (Cashmere or Cashgora producing):	
	Rising one-year does	96.00
	Mixed-age does	131.00
	Rising one-year bucks (non-breeding)/wethers	76.00
	Bucks (non-breeding)/wethers over one year	79.00
	Breeding bucks	387.00
	Milking (dairy) goats:	
	Rising one-year does	213.00
	Does over one year	300.00
	Breeding bucks	580.00
	Other dairy goats (culls)	78.00
Pigs	Breeding sows less than one year of age	257.00
	Breeding sows over one year	332.00
	Breeding boars	374.00
	Weaners less than 10 weeks of age (excluding sucklings)	108.00
	Growing pigs 10 to 17 weeks of age (porkers and baconers)	151.00
	Growing pigs over 17 weeks of age (baconers)	226.00

This determination was signed by me on the 26th day of May 2022.

Rob Falk
Technical Lead, Technical Standards, Legal Services
Inland Revenue

References

Legislative References

Income Tax Act 2007: s EC 15

BINDING RULINGS

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

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

BR Pub 22/06: Fringe Benefit Tax – Charitable and Other Donee Organisations and Fringe Benefit Tax

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

Taxation laws

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

This Ruling applies in respect of section CX 25.

The Arrangement to which this Ruling applies

The Arrangement is the provision of a non-monetary benefit by a charitable or other donee organisation, not being a local authority, public authority or university, (the qualifying organisation) to an employee of that organisation.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- Where a short-term charge card facility (as defined in s CX 25(3)) is provided to an employee of a qualifying organisation and the value of that benefit for the employee in a tax year is more than the lesser of 5% of the employee's salary or wages or $1,200, that benefit is a fringe benefit and the exclusion in s CX 25(1) does not apply.
- Where any other non-monetary benefit is provided to an employee of a qualifying organisation:
  - A fringe benefit **is not** provided where the benefit is not received mainly in connection with their employment.
  - A fringe benefit **is not** provided where the benefit is received mainly in connection with their employment to the extent that:
    - the employee is employed in carrying out the qualifying organisation's benevolent, charitable, cultural or philanthropic purposes; or
    - the employee is employed in a business carried on by the qualifying organisation, where the business activity is within (ie, carries out) the organisation's benevolent, charitable, cultural or philanthropic purposes.
  - A fringe benefit **is** provided where the benefit is received mainly in connection with the employee's employment, to the extent that the employee is employed in a business carried on by the qualifying organisation, where the business activity is outside (ie, does not carry out) the organisation's benevolent, charitable, cultural, or philanthropic purposes, regardless of whether business profits are applied to the organisation's benevolent, charitable, cultural or philanthropic purposes.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 1 July 2022.

This Ruling is signed by me on 31 May 2022.

Grant Haley
Tax Counsel Lead, Public Advice and Guidance

Commentary on Public Ruling BR Pub 22/06

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 22/06 ("the Ruling").

Summary

1. Section CX 25 excludes some benefits provided to employees by qualifying non-profit organisations from being fringe benefits for fringe benefit tax (FBT) purposes. This Ruling and commentary explains which organisations the FBT exclusion applies to and how it applies.
2. The exclusion in s CX 25 applies to "charitable organisations". This term is defined in s YA 1. It includes most organisations usually referred to as "donee organisations"; that is, any associations, funds, institutions, organisations, societies or trusts that are not carried on for the private pecuniary profit of an individual and whose funds are applied wholly or mainly to benevolent, charitable, philanthropic or cultural purposes ("specified purposes"). However, local authorities, public authorities and universities are specifically excluded from being "charitable organisations" for FBT purposes (and therefore the ordinary FBT rules apply to them). Most organisations which are donee organisations will be recorded on Inland Revenue's approved donee list. For ease of reference, in this commentary the organisations that can rely on the FBT exclusion in s CX 25 are referred to as "qualifying organisations".
3. Qualifying organisations carry on a variety of activities. Those activities may include business activities. Those business activities may be within the organisation's specified purposes or outside those purposes – even if undertaken to help fund the organisation's specified purposes.
4. Essentially, the FBT exclusion in s CX 25 applies where a qualifying organisation provides a benefit to an employee mainly in connection with their employment, in an activity carried on within the organisation's specified purposes.
5. The exclusion does **not** apply where a qualifying organisation provides a benefit to an employee mainly in connection with their employment, to the extent the benefit is provided in a business activity carried on outside the qualifying organisation's specified purposes.
6. The distinction between business activities that are within, or outside of, the qualifying organisation's specified purposes is specific to the FBT exclusion. It is not relevant for other purposes. Whether the FBT exclusion applies is a different question to whether
   s CW 42 applies to exempt a qualifying organisation's business income. A qualifying organisation's income may be entirely exempt under s CW 42 while the FBT exclusion may not apply to all fringe benefits provided.
7. The exclusion also does **not** apply to benefits provided by a qualifying organisation to an employee by way of short-term charge facilities (ie, credit or charge cards), if the value of those benefits in a tax year exceeds the lesser of 5% of the employee's salary or wages for the tax year or $1,200.
8. **Figure 3: Exclusion from FBT for qualifying organisations** on page 21 summarises the approach to take to decide whether the exclusion in s CX 25 applies.

Background

9. This Ruling is a reissue of BR Pub 17/06: Fringe Benefit Tax – Charitable and Other Donee Organisations and Fringe Benefit Tax which expires on 30 June 2022. This Ruling will apply for an indefinite period from 1 July 2022.

10. BR Pub 17/06 replaced "Public Ruling BR Pub 09/03: Charitable Organisations and Fringe Benefit Tax", *Tax Information Bulletin* Vol 21, No 6 (August 2009): 12. BR Pub 09/03 was withdrawn from 30 June 2017. It was a reissue of "Charitable Organisations and Fringe Benefit Tax (FBT): Public Ruling BR Pub 00/08", *Tax Information Bulletin* Vol 12, No 9 (September 2000): 3.
11. BR Pub 09/03 was withdrawn because the Commissioner's view on aspects of that ruling has changed. BR Pub 09/03 was published for an indefinite period. Therefore, on withdrawal, the Commissioner continued to be bound by it for arrangements entered into before the withdrawal date for a further three years (see s 91DE(4A) of the Tax Administration Act 1994).

Approach taken to analysis

12. The approach taken in this commentary is to:
    - briefly consider the legislative context of the FBT exclusion in s CX 25;
    - identify types of organisations that may qualify for the FBT exclusion (qualifying organisations);
    - address the following issues arising from the exception to the FBT exclusion (as set out in s CX 25(1)(a) and (b)):
        - when a benefit received by an employee is mainly in connection with their employment;
        - when a qualifying organisation's activity is a business;
        - when a qualifying organisation's business activity is within its specified purposes;
    - discuss whether s CX 25(1) contemplates apportionment; and
    - consider briefly the rules regarding credit cards, charge cards and some vouchers provided to employees of a qualifying organisation.

Legislative context of the FBT exclusion

13. Under the Act, an employer may be liable to pay FBT on fringe benefits that it provides to an employee. "Fringe benefit" is defined in s CX 2(1) as follows:

> *Meaning*
>
> (1) A **fringe benefit** is a benefit that —
>
> (a) is provided by an employer to an employee in connection with their employment; and
>
> (b) either—
>
> (i) arises in a way described in any of sections CX 6, CX 9, CX 10, or CX 12 to CX 16; or
>
> (ii) is an unclassified benefit; and
>
> (c) is not a benefit excluded from being a fringe benefit by any provision of this subpart.

14. This definition is broad and intended to include all non-cash payments an employer makes to an employee in connection with their employment.
15. Section CX 25(1) excludes benefits provided by certain qualifying organisations to their employees from being fringe benefits, except in certain circumstances (see s CX 25(1)(a) and (b)):

> **CX 25 Benefits provided by charitable organisations**
>
> *When not fringe benefit*
>
> (1) A charitable organisation that provides a benefit to an employee does not provide a fringe benefit except to the extent to which—
>
> (a) the employee receives the benefit mainly in connection with their employment; and
>
> (b) the employment consists of the carrying on by the organisation of a business whose activity is outside its benevolent, charitable, cultural, or philanthropic purposes.

16. Section CX 25(2) and (3) also limits the exclusion in s CX 25(1) by providing that the exclusion does not apply to benefits provided to an employee by way of short-term charge facilities if the value of those benefits in a tax year is more than the lesser of 5% of the employee's salary or wages for the tax year or $1,200.

Applying the legislation

17. For a benefit to be a fringe benefit, it must be provided by an employer to an employee in connection with their employment and must not be excluded from being a fringe benefit by one of the exclusions in subpart CX (see s CX 2 Meaning of fringe benefit). Where the employer is a "charitable organisation" (as defined in s YA 1), a benefit provided to an employee is excluded from being a fringe benefit by s CX 25(1), except in certain circumstances. This means that, to the extent the exclusion in s CX 25 applies, no FBT is payable on the benefit provided to the employee by the charitable organisation.

What types of organisations qualify for the FBT exclusion in s CX 25?

18. The FBT exclusion in s CX 25 applies to charitable organisations which are defined in s YA 1 for the purposes of the FBT exclusion:

> **charitable organisation —**
>
> (a) means, for a quarter or an income year, **an association, fund, institution, organisation, society, or trust to which section LD 3(2) (Meaning of charitable or other public benefit gift) or schedule 32 (Recipients of charitable or other public benefit gifts)** applies— the employee receives the benefit mainly in connection with their employment; and
>
> (i) in the quarter; or
>
> (ii) in the income year, if fringe benefit tax is payable on an income year basis under section RD 60 (Close company option); and
>
> (aa) includes a person who has been removed from the register of charitable entities (the register) under the Charities Act 2005, but only for the period starting on the day the person is registered on the register and ending on the earlier of the last day of the following periods:
>
> (iii) the quarter, or income year if section RD 60 (Close company option) applies, in which the person does not comply with their rules contained in the register:
>
> (iv) the quarter, or income year if section RD 60 applies, in which the day of final decision falls; and
>
> **(b) does not include a local authority, a public authority, or a university**.
>
> [Emphasis added.]

19. The definition of "charitable organisation" essentially relies on the description of a "donee organisation" set out in the tax credit rules for charitable or other public benefit gifts. However, it specifically **excludes** local authorities, public authorities or universities.

20. The tax credit rules for charitable or other public benefit gifts provide a description of the types of organisation to be treated as a "donee organisation" for gifting purposes in s LD 3(2):

Description of organisations

(1) The following are the entities referred to in subsection (1)(a) and (b):

(a) a society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual, and whose funds are applied wholly or mainly to charitable, benevolent, philanthropic, or cultural purposes within New Zealand: in the income year, if fringe benefit tax is payable on an income year basis under section RD 60 (Close company option); and

(b) an entity that, but for this paragraph, no longer meets the requirements of this subsection, but only for the period starting on the day it fails to meet those requirements and ending on the later of—

(i) the day the entity is removed from the register of charitable entities under the Charities Act 2005:

(ii) the day on which all reasonably contemplated administrative appeals and Court proceedings, including appeal rights, are finalised or exhausted in relation to the person's charitable status.

(c) community housing entity, if the gift is made at a time the entity is eligible to derive exempt income under section CW 42B (Community housing trusts and companies):

(d) a public institution maintained exclusively for any 1 or more of the purposes within New Zealand set out in paragraph (a):

(e) a board that is constituted under subpart 5 of Part 3 of the Education and Training Act 2020 and is not carried on for the private pecuniary profit of any individual:

(f) a tertiary education institution:

(g) a fund established and maintained exclusively for the purpose of providing money for any 1 or more of the purposes within New Zealand set out in paragraph (a), by a society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual:

(h) a public fund established and maintained exclusively for the purpose of providing money for any 1 or more of the purposes within New Zealand set out in paragraph (a).

21. Organisations of the types described in s LD 3(2) essentially include associations, funds, institutions, organisations, societies or trusts that:

- are not carried on for the personal gain of an individual; and
- apply their funds wholly or mainly to charitable, benevolent, philanthropic or cultural purposes within New Zealand.

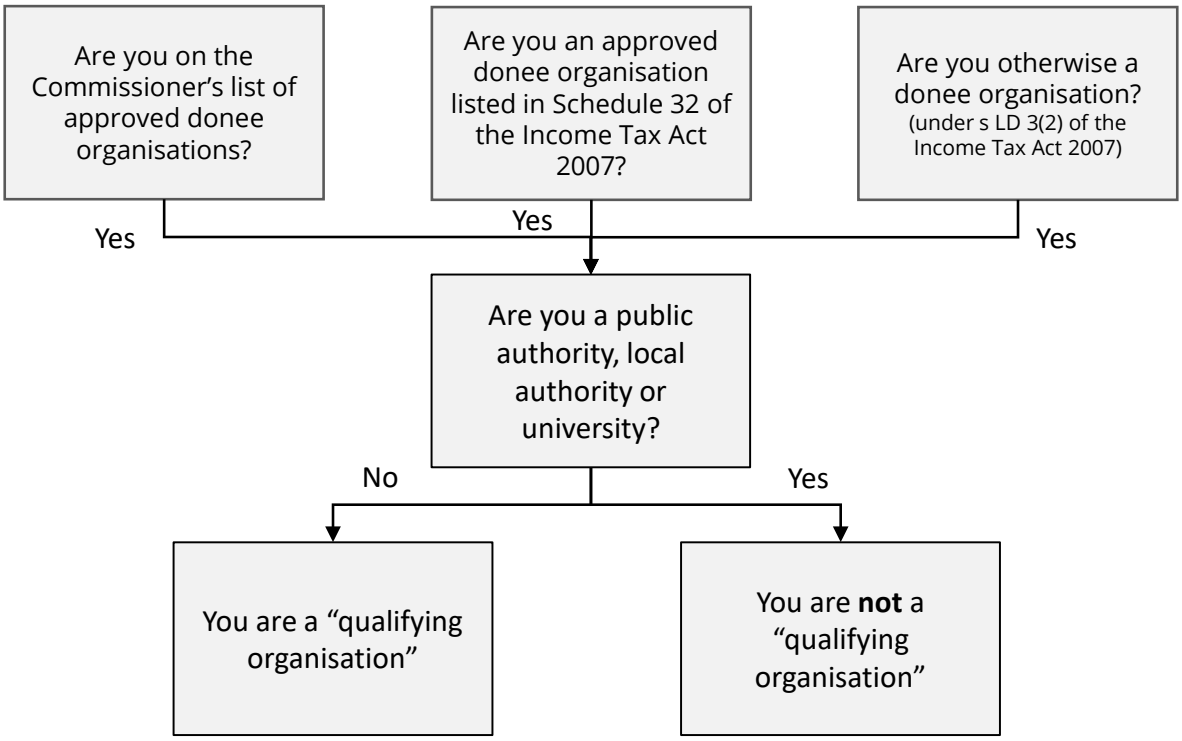
22. The definition of "charitable organisation" also includes organisations listed in schedule 32. Schedule 32 lists certain named organisations that Parliament has approved as being "recipients of charitable or other public benefit gifts". These are often international charities with a New Zealand presence, which would not otherwise qualify as "donee organisations" as they do not apply their funds wholly or mainly **within** New Zealand.[1]

23. There is significant overlap in s YA 1 between "charitable organisations" (used for the FBT exclusion) and "donee organisations". Both definitions include organisations described in s LD 3(2) and those listed in sch 32. However, the definition of "charitable organisations" excludes local authorities, public authorities and universities. Due to this overlap the term "qualifying organisation" is used to describe the charitable and donee organisations that the FBT exclusion in s CX 25 applies to (i.e. donee organisations, excluding those that are local authorities, public authorities or universities).

24. Most qualifying organisations will either be on the Commissioner's list of approved donee organisations or listed in schedule 32. **Figure 1: Are you a qualifying organisation?** illustrates this:

[1] The meaning of the phrase "wholly or mainly" in s LD 3(2) is discussed in *IS 18/05: Income tax – donee organisations – meaning of wholly or mainly applying funds to specified purposes within New Zealand.*

Figure 1: Are you a qualifying organisation?



Exceptions to the FBT exclusion

25. Generally, qualifying organisations are not subject to FBT. However, there are two exceptions to the FBT exclusion:
    - The first exception is where benefits are provided mainly in connection with employment to employees who work for businesses outside the organisation's specified purposes.
    - The second exception is where the benefits are provided by way of short-term charge facilities (discussed at [67]).

The first exception to the FBT exclusion

26. This first exception is set out in s CX 25(1) and has two limbs, paras (a) and (b):

> **CX 25 Benefits provided by charitable organisations**
>
> *When not fringe benefit*
>
> (1) A charitable organisation that provides a benefit to an employee does not provide a fringe benefit except to the extent to which—
>
> (a) the employee receives the benefit mainly in connection with their employment; and
>
> (b) the employment consists of the carrying on by the organisation of a business whose activity is outside its benevolent, charitable, cultural, or philanthropic purposes.

27. The first limb of the exception in s CX 25(1) considers whether a benefit is received by the employee mainly in connection with their employment. The second limb looks at the activities being carried on by a qualifying organisation in which the employee is engaged.

When is a benefit received by an employee mainly in connection with their employment?

28. The first limb of the exception (s CX 25(1)(a)) requires the employee to receive the benefit mainly in connection with their employment.

29. In the Commissioner's view, this wording recognises that a qualifying organisation may provide benefits to people who are acting in different capacities for the organisation. It is not unusual for people to be employed by an organisation in a particular role and for those same people to also provide additional or different services to the organisation, for example, on a voluntary (unpaid) basis.

30. In the Commissioner's view, the purpose of the wording in s CX 25(1)(a) is to clarify that a potential liability for FBT will arise only where an employee receives a benefit from a qualifying organisation mainly in their employment capacity and not in some other capacity (eg, in their voluntary capacity).
31. The word "mainly" is used in s CX 25 as a result of the rewrite of the Income Tax Act. The intended meaning of "mainly" in the rewritten Act is discussed in *Tax Information Bulletin* Vol 16, No 5 (June 2004) (at p 71):

> Mainly
>
> The rewritten provisions use "mainly" in place of "primarily and principally" and similar expressions. The expression "primarily and principally" was considered by Eichelbaum J in *Newman[s] Tours Ltd v CIR* (1989) 11 NZTC 6,027 (High Court). The judge interpreted the expression as requiring that the purpose not only be the main one, in the sense of outweighing all the other purposes, singly or collectively, but also the primary one - that is, the first one. Sufficiently similar connotations can be conveyed in the single word "mainly".

32. Therefore, a benefit will be provided to an employee of a qualifying organisation **mainly** in connection with their employment if the benefit arises primarily in connection with their employment. If an employee is only employed by a qualifying organisation, and does no voluntary work, then any benefits provided to that employee will be provided in connection with their employment. But, if, for example, an employee is both employed by and works as a volunteer for a qualifying organisation, it will be necessary to determine in which capacity the benefit primarily arises.
33. If a benefit arises equally in connection with both their capacities, the benefit will be provided mainly in connection with the capacity in which the employee is predominantly engaged.

When is a qualifying organisation's activity a business?

34. Under the second limb of the exception (s CX 25(1)(b)), the FBT exclusion in s CX 25(1) does not apply to the extent that a benefit is provided to an employee whose:

> employment consists of the carrying on by the organisation of a business whose activity is outside its benevolent, charitable, cultural, or philanthropic purposes.

35. Therefore, the next issue is whether the employee is employed in a business carried on by the qualifying organisation. "Business" is defined in s YA 1 as including:

> any profession, trade, or undertaking carried on for profit:

36. The leading case on what constitutes a business is *Grieve v CIR* (1984) 6 NZTC 61,682 (CA). The Court found that determining whether a taxpayer is in business involves a two-fold inquiry as to:
    - the nature of the activities carried on; and
    - the intention of the taxpayer in engaging in those activities.
37. In the leading judgment, Richardson J (at 61,691) 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 taxpayer engages in that activity;
    - scale of operations and the volume of transactions;
    - commitment of time, money and effort;
    - pattern of the activity; and
    - financial results.
38. Richardson J also stated that it may also be helpful to consider whether the operations involved are characteristic of that kind of business. However, in the end, it is the **character** and **circumstances** of the **particular venture** that are crucial.
39. Many qualifying organisations engage in activities on a continuous and ongoing basis, commit time, money and effort to those activities, and conduct a large volume of transactions, with the intention of making a surplus. Such organisations that carry on this type of activity are carrying on a business, as that term is defined in s YA 1.
40. A qualifying organisation carrying on a business (eg, a private school operated by a charitable trust) may still qualify for the FBT exclusion even though it makes a profit. Just because an organisation carries on some activities for profit does not

prevent the organisation from being a qualifying organisation for FBT purposes, so long as the activity is not being carried on for the personal gain of an individual. This view is consistent with one of the key descriptions of a "donee organisation" in s LD 3(2)(a):

> a society, institution, association, organisation, or trust that is **not carried on for the private pecuniary profit of an individual**, and whose **funds are applied wholly or mainly to charitable, benevolent, philanthropic, or cultural purposes** within New Zealand.
>
> [Emphasis added]

When is a qualifying organisation's business activity within its benevolent, charitable, cultural or philanthropic purposes?

41. After considering whether the qualifying organisation's activity is a business, the next issue under s CX 25(1)(b) is whether the:

> employment consists of the carrying on by the organisation of a business **whose activity is outside its benevolent, charitable, cultural, or philanthropic purposes**.
>
> [Emphasis added]

42. If a qualifying organisation provides benefits to an employee who is employed in a business they are carrying on, the FBT exclusion may apply. The extent to which the FBT exclusion applies depends on whether the business activity being carried on is within or outside the organisation's benevolent, charitable, cultural, or philanthropic purposes:
    - for business activities **within** these purposes, the FBT exclusion applies; and
    - for business activities **outside** these purposes, the FBT exclusion does not apply.
43. The distinction between business activities that are within, or outside of, the qualifying organisation's specified purposes is specific to the FBT exclusion. This is not a distinction that is relevant for income taxation purposes, or when determining whether an organisation is a charitable entity for the purposes of the Charities Act 2005.
44. Applying the second limb of the exception requires an understanding of the types of activities the qualifying organisation is carrying on. Sometimes activities will be within a qualifying organisation's specified purposes and sometimes activities will be outside those purposes.
45. The distinction between activities carried on within a qualifying organisation's specified purposes and outside those purposes was discussed in *Trustees of the Dean Leigh Temperance Canteen v Commissioners of Inland Revenue* (1958) 38 TC 315. The High Court of Justice (Chancery Division) considered whether a charity could carry on a business activity that was within its charitable purposes. This was in the context of determining whether income derived by the trustees was exempt from tax. In the United Kingdom at that time, income from a business was exempt from tax if that business was carried on in the course of carrying out a primary purpose of the charity.
46. The trust was established for the purpose of promoting temperance. It operated a canteen selling non-alcoholic drinks and light refreshments at normal market prices in a marketplace. The canteen made considerable profits. The issue before the court was essentially whether the canteen activity was a business exercised in the course of carrying out the primary purpose of the charity. The court concluded that the object of the trust was to promote temperance and "the canteen was the engine in their hand for that purpose" (at 325). In other words, the canteen activity was a business activity within (and not outside) the trust's charitable purposes. Accordingly, the income derived from the canteen business was exempt from tax.
47. Another case that considers the distinction between activities carried on by a charity is *Oxfam v City of Birmingham District Council* [1975] 2 All ER 289 (HL). In *Oxfam,* the House of Lords found that where a charity carried out its charitable objects or directly facilitated the carrying out of the charitable objects (such as administrative or clerical activities), it was acting within its charitable purposes. However, where a charity carried on a trading activity that did not carry out its charitable objects, that activity would be outside the charity's charitable purposes. This is the case even if all funds raised from the activity are applied to the charity's charitable purposes.
48. The House of Lords was considering whether Oxfam's gift shops were on premises wholly or mainly used for charitable purposes. The court found that, although the gift shops were used for purposes indirectly related to the achievement of the objects of the charity (ie, selling donated goods to raise money for the charity), the premises were not wholly or mainly used for charitable purposes.

49. In reaching this conclusion, the House of Lords drew a line between the use of premises for purposes that are the charity's charitable purposes and the use of premises for purposes that, though purposes of the charity, are not charitable purposes. Lord Cross said at 293:

> The wording of s 40(1) of the [General Rate Act 1967] shows that the legislature did not consider that the mere fact that the hereditament in question is occupied by a charity justifies any relief from rates. That is only justified if the hereditament is being used for 'charitable purposes' of the charity. So the first question which arises is: what are 'charitable purposes' of a charity as distinct from its other purposes? The answer must be, I think, those purposes or objects the pursuit of which make it a charity — that is to say in this case the relief of poverty, suffering and distress.

50. As well as "those purposes or objects the pursuit of which make it a charity", Lord Cross recognised that activities that are "wholly ancillary to" or "directly facilitate" the carrying out of an organisation's charitable objects will be part of fulfilling the organisation's charitable objects. Fundraising through the gift shops did not meet those criteria.

51. In the Commissioner's view, these cases support the view that activities (including business activities) undertaken to carry out the benevolent, charitable, cultural or philanthropic objects of a qualifying organisation or directly facilitating the carrying out of those objects (including administrative or clerical activities) will be within the benevolent, charitable, cultural or philanthropic purposes of the organisation for the purposes of s CX 25. However, trading activities carried on to raise funds for the organisation that do not in themselves carry out the charitable purposes of the organisation will not be within the benevolent, charitable, cultural or philanthropic purposes of a qualifying organisation for the purposes of s CX 25. This is the case even if all the funds raised from the activity are applied to the qualifying organisation's purpose.

52. Therefore, the Commissioner considers activities will be carried on *within* a qualifying organisation's purposes when they:

- are the performance of a qualifying organisation's specified purposes; or
- directly facilitate the carrying out of a qualifying organisation's specified purposes.

53. Activities the Commissioner considers will usually be characterised as being carried on *within* a qualifying organisation's specified purposes include:

- the carrying out of the qualifying organisation's specified purposes;
- appeals for funds for the qualifying organisation's specified purpose;
- passive investment and management of the qualifying organisation's funds, so long as the organisation does not carry on a business of fund investment; and
- the administration of the above activities.

54. On the other hand, business activities that are carried on to raise funds for the qualifying organisation and that are not of themselves achieving a qualifying organisation's specified purposes, or which do not directly facilitate those purposes, will be treated as business activities outside the purposes of a qualifying organisation. This is the case even if the profits from such business activities are used to fund the qualifying organisation and thereby help it carry out its specified purposes. For example, a clothing thrift shop run by an animal welfare organisation is a business activity that is *outside* the organisation's object of caring for animals.

55. Applying this approach to s CX 25(1), where benefits are received mainly in connection with employment, to the extent an employee is engaged in activities carrying out a qualifying organisation's specified purposes (including the carrying on of a business activity), benefits provided to them will not attract FBT. However, to the extent a qualifying organisation's employee is engaged in business activities of the organisation that are not of themselves benevolent, charitable, cultural or philanthropic, any benefits provided to the employee will not fall within the exclusion provided by s CX 25, and so may attract FBT.

56. It will be a question of fact in each case whether the business activities of a qualifying organisation are activities that are not of themselves achieving the organisation's specified purposes. It is, therefore, possible that two qualifying organisations may carry out similar business activities, with different FBT consequences for each organisation. An example of this is where a qualifying organisation operates retail stores selling goods with a view to making a profit. This type of activity would generally be considered to be outside an organisation's specified purposes, although for some organisations such an activity might fall within their purposes. For example, if the operation of a particular retail store served the purpose of creating job opportunities for a group that the organisation was established to assist, or if the goods were provided at low cost to a group the organisation was established to assist. This business activity may be considered to be achieving the organisation's specified purposes.

Whether s CX 25(1) contemplates apportionment

57. Just as a person may work for a qualifying organisation in different capacities (eg, as a volunteer or as an employee), an employee may also be employed by a qualifying organisation in different activities, some of which may be within the organisation's specified purposes and some of which may be outside those purposes.

58. Section CX 25(1) provides that:

> **CX 25 Benefits provided by charitable organisations**
>
> *When not fringe benefit*
>
> (1) A charitable organisation that provides a benefit to an employee does not provide a fringe benefit except **to the extent to which—**
>
> (a) the employee receives the benefit mainly in connection with their employment; **and**
>
> (b) the employment consists of the carrying on by the organisation of a business whose activity is outside its benevolent, charitable, cultural, or philanthropic purposes.
>
> [Emphasis added]

59. In the Commissioner's view, the phrase "to the extent to which" in s CX 25(1) applies to both paras (a) and (b), but in para (a) it is qualified by the word "mainly". The word "and" between the paragraphs indicates that both paragraphs (ie, both the first and second limbs of the exception) need to be satisfied for the exclusion not to apply.

60. The word "extent" is defined in the *Concise Oxford English Dictionary* (12th ed, Oxford University Press, 2011) as meaning:

> *n*. **1** the area covered by something. The size or scale of something. **2** the degree to which something is the case: *everyone has to compromise to some extent*

61. The Court of Appeal in *CIR v Banks* (1978) 3 NZTC 61,236 and *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 held that the phrase "to the extent to which" expressly contemplates apportionment. On this point, Richardson J stated in *Buckley & Young* at 61,274:

> The second feature of sec. 111 is that the **statutory language contained in the phrase "to the extent to which" expressly contemplates apportionment**. In *Banks* this Court said, in relation to this aspect of deductibility (p. 61,241):
>
> > "A deduction is allowed to the extent that the statutory standard of deductibility is met. Furthermore, this is not restricted to expenditure which can be dissected with distinct and severable parts being directly referable to the production of assessable income. It extends to outgoings not capable of such dissection but which serve both income earning and other purposes indifferently (*Ronpibon Tin N.L. & Tongkah Compound N.L. v F.C. of T*. (1949) 78 C.L.R. 47."
>
> While sec. 112(a) does not expressly provide in the same way for apportionment between capital and revenue, **at the same time it does not provide to the contrary, for example, by the use of the familiar qualification in taxation legislation "wholly and exclusively"**. Section 112(a) operates as a restriction on deductibility and, as a matter of construction, applies only in so far as the expenditure is of a capital character. In The Texas Company (Australasia) Limited v F.C. of T. (1940) 63 C.L.R. 382, 466 referring to the then counterpart of sec. 112(a) Dixon J. said:
>
> > "There is I think nothing which prevents the division or apportionment between capital and income of an outgoing which is in part of a capital nature and in part of a revenue nature."
>
> In our view the same approach is to be made whether the apportionment is under sec. 111 or between capital and revenue expenditure [Emphasis added]

62. In *Banks*, Richardson J also made the observation at 61,243– 61,244 that "[i]ndeed, the expressions 'to the extent' and 'so far as' demonstrate the absence of a statutory minimum applicable in all cases".

63. Richardson J makes it clear that the phrase "to the extent to which" expressly contemplates apportionment. Richardson J does, however, acknowledge that the phrase may not have this meaning if it is qualified with a term like "wholly and exclusively". Therefore, applying that reasoning to s CX 25(1), the word "mainly" in s CX 25(1)(a) could be read as qualifying the phrase "to the extent to which". However, in the Commissioner's view, in s CX 25(1)(a) the word "mainly" places the focus on establishing the principal reason for the employee receiving the benefit. For example, whether the employee received the benefit mainly in connection with their employment or mainly in connection with their role as a volunteer. If it is mainly received in connection with volunteer service, the benefit is not a fringe benefit. However, if the benefit is

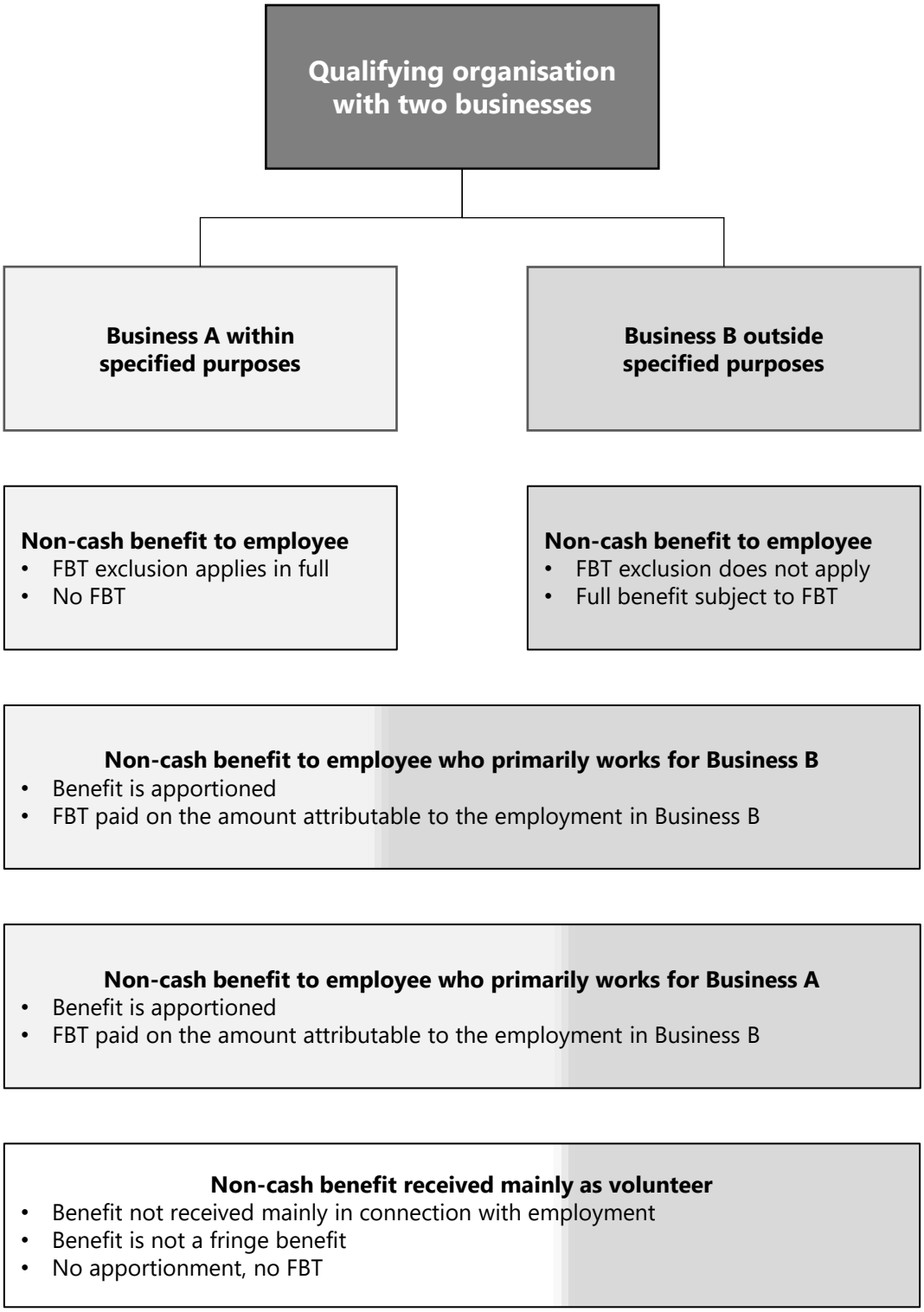
provided mainly in connection with employment (ie, s CX 25(1)(a) is satisfied) then any volunteer service is disregarded for the purposes of s CX 25(1)(b). This is because only employment is considered for the purposes of applying the second limb of the exclusion in s CX 25(1)(b).

64. Unlike in s CX 25(1)(a), there are no words in s CX 25(1)(b) to qualify the phrase "to the extent to which". This means that, for the purposes of s CX 25(1)(b), the words "to the extent to which" should be given their ordinary meaning (ie, requiring apportionment). Therefore, under s CX 25(1)(b) a qualifying organisation will be subject to FBT only **to the extent to which** that benefit is provided to an employee in connection to their employment in a business activity that is outside the organisation's specified purposes.

65. In summary, the Commissioner considers FBT will apply only to benefits provided to an employee **mainly in connection with their employment**, and then only **to the extent to which** those benefits are received in connection with **employment in a business carried on outside** a qualifying organisation's purposes. Where an employee is employed in different activities across a qualifying organisation and one or more of those activities is a business activity outside the organisation's purposes, the benefits provided need to be apportioned so only the benefits relating to the employment in the business activity carried on outside the organisation's specified purposes are treated as fringe benefits. In the Commissioner's view, any apportionment should be reasonable and reflect the reality of the situation. Example 4 provides an example of a reasonable apportionment basis, based on working hours.

66. **Figure 2: First exception to the FBT exclusion** on the next page shows the application of the FBT exclusion where a qualifying organisation provides non-cash benefits to employees across two business activities and only one business activity is within the qualifying organisation's specified purposes.

Figure 2: First exception to the FBT exclusion



The second exception to the FBT exclusion

67. The second exception to the FBT exclusion relates to short-term charge facilities (ie, credit and charge cards). Section CX 25(2) states that the exclusion in s CX 25(1) does not apply, and a fringe benefit **is** provided when a qualifying organisation provides a benefit to an employee by way of a short-term charge facility and the value of the benefit is more than the lesser of 5% of the employee's salary and wages for a tax year and $1,200.

68. Subsection (3) defines the term "short-term charge facility":

> *Meaning of short-term charge facilities*
>
> (1) For the purposes of the FBT rules, a **short-term charge facility** means an arrangement that—
>
> (a) enables an employee to obtain goods or services that have no connection with the employer or its operations by—
>
> (i) buying or hiring the goods or services:
>
> (ii) charging the cost of the goods or services to an account:
>
> (iii) providing consideration other than money for the goods or services; and
>
> (b) requires the employer to provide some or all of the payment or other consideration for the goods or services; and
>
> (c) is not a fringe benefit under section CX 10.

69. Employment-related loans (s CX 10) are explicitly excluded from the meaning of short-term charge facilities under s CX 25(3)(c). As a result, the second exception would not apply to an employment-related loan provided by a qualifying organisation with a value greater than the lesser of 5% of an employee's wages or $1,200 for a tax year. However, the first exception may still apply (i.e. if the loan was provided in relation to employment in business activities outside the qualifying organisation's specified purposes). Example 4 and Example 5 illustrate these points.

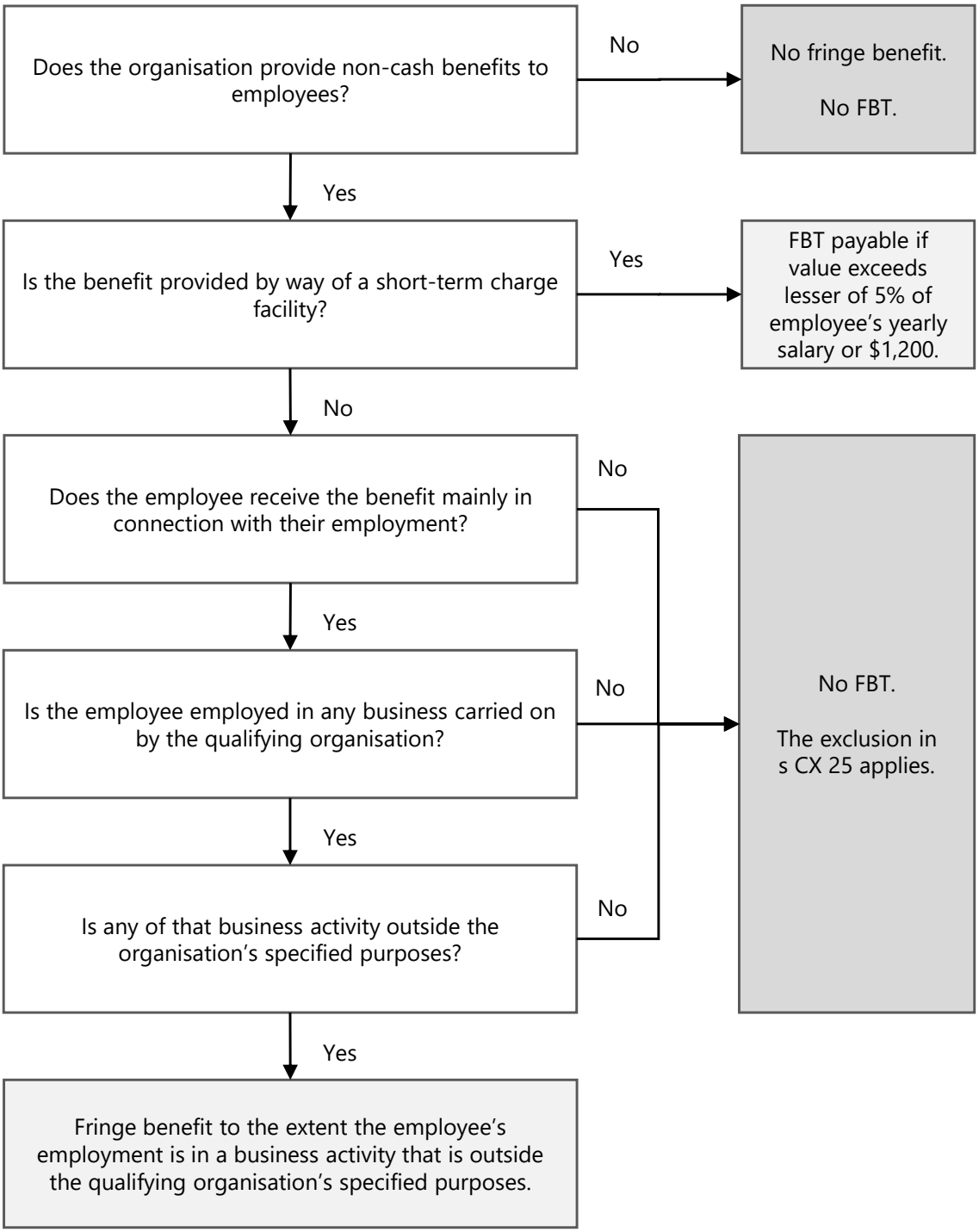
70. Short-term charge facilities include things like enabling employees to use business charge accounts or business credit cards for private use without paying associated costs. They also include the provision of some vouchers or store gift cards (for example: gas station or supermarket vouchers).

71. If you agree to provide vouchers to an employee and deduct their salary to the same amount, this may in fact represent employment income under s CE 1 rather than fringe benefits. *Revenue Alert RA 13/01* discusses this topic in more detail.

72. If s CX 25(2) applies to a benefit provided by way of short-term charge facility to a qualifying organisation's employees, the benefits are subject to FBT. Example 6 illustrates this point.

Flowchart summarising the FBT exclusion

Figure 3: Exclusion from FBT for qualifying organisations



Examples

Example 1: Private school operated by a charitable organisation

A non-profit organisation has the principal purpose of providing education through a private school. The organisation is a charitable organisation for the purposes of the FBT rules because it is not carried on for the private gain of any individual and its funds are applied wholly or mainly for the advancement of education within New Zealand.

The organisation charges tuition fees for the education it provides and has had surpluses of income over expenditure for the last three income years. It provides a car to its school principal for work and private use.

The organisation is not liable for FBT on the benefit arising from the private use or availability for the private use of the car provided to the principal. This is because the benefit is provided by a charitable organisation to an employee who is employed in an activity that is within the charitable organisation's specified purposes. The employee is not employed in a business activity that is carried on by the charitable organisation outside its specified purposes.

Example 2: Farming activity within private school

The organisation from Example 1 also conducts a farming business on land adjacent to the private school. The farming operation is carried on as a business and it directly facilitates the practical component of the school's agricultural courses. The organisation provides a car to its farm manager for work and private use.

The organisation is not liable for FBT on the benefit arising from the private use or availability for private use of the car provided to the farm manager. This is because the farm manager is employed by the charitable organisation to carry out its specified purposes (ie, the advancement of education). In this case, the carrying on of the farming business falls within the specified purposes of the organisation because of its direct relationship with the private school's agricultural curriculum.

Example 3: Farming activity outside private school

This example has the same facts as in Example 2, except the farming business does not directly facilitate the education of the students at the private school. Any profits earned are put back into the school. However, the farm is not used to educate students at the school.

In this situation, the organisation is liable for FBT on the benefit arising from the private use or availability for private use of the car provided to the farm manager. This is because the farm manager is employed in a business activity that falls outside the specified purposes of the organisation. This remains the case despite the fact the profit made from the farming activity is put back into the private school.

Example 4: Employee in food bank and shop

A charitable organisation has the principal purpose of relieving poverty by running a food bank. The organisation is a charitable organisation for the purposes of the FBT rules because it is not carried on for the private gain of any individual and its funds are applied wholly or mainly for charitable purposes (ie, the relief of poverty) within New Zealand. The organisation also runs a shop that sells office supplies (purchased from a wholesaler) to the public. The profit made from the shop is used to purchase food for the food bank.

The organisation has a policy of providing low-interest loans to all employees. Peter is employed by the organisation to work three days a week in the shop and two days a week in the food bank. He receives a low-interest loan from the organisation.

A fringe benefit arises to the extent to which Peter's employment consists of the charitable organisation carrying on a business activity that is outside the organisation's charitable purposes. In this case, 60% of Peter's employment is for the charitable organisation carrying on a business activity that is outside that organisation's charitable purposes. Therefore, the charitable organisation is liable for FBT on 60% of the value of the fringe benefit arising from the provision of the low-interest loan to Peter.

Example 5: Voluntary work in food bank

This example has similar facts to Example 4, except that Peter is employed to work in the shop only two days a week, and for the remaining three days he volunteers to work for the organisation in the food bank. The low-interest loan is available to anyone who works regularly (as an employee or a volunteer) in the food bank.

In this situation, the organisation is not liable for FBT on the benefit arising from the provision of the low-interest loan to Peter. This is because the benefit is not received mainly in connection with Peter's paid employment, but instead is received mainly in connection with his unpaid role as a volunteer in the food bank. This is because Peter predominantly works as a volunteer in the food bank. The benefit is not a fringe benefit and therefore no apportionment is required.

Example 6: Fuel card

A charitable organisation employs a secretary at its head office. The secretary's employment involves administrative matters relating to the running of the organisation. The secretary's salary is $40,000 for the tax year. On top of the salary, the organisation provides the secretary with a fuel card for use at a local petrol station. The fuel card is in the organisation's name and the organisation is liable to pay any amounts charged to the card. The secretary uses the card to obtain at least $80 worth of petrol every week.

The provision of the fuel card to the secretary is a fringe benefit. It does not matter that the secretary is employed in an activity within the charitable organisation's charitable purposes (ie, administrative work at an organisation's head office). The organisation is liable for FBT because the benefit is provided by way of a short-term charge facility and the value of the benefit is more than $1,200 in the tax year, being the lesser of 5% of the secretary's salary or wages for the tax year and $1,200. The benefit, therefore, is a fringe benefit under s CX 25(2).

References

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business

charitable organisation

FBT

fringe benefit

fringe benefit tax

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Legislative references

Charities Act 2005

Income Tax Act 2007, ss YA 1 (definitions of "business", "charitable organisation", "donee organisation"), CX 2, CX 10, CX 25, LD 3(2), and sch 32

Tax Administration Act 1994, s 91DE(4A)

Case references

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

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

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

Oxfam v City of Birmingham District Council [1975] 2 All ER 289 (HL)

Trustees of the Dean Leigh Temperance Canteen v Commissioners of Inland Revenue (1958) 38 TC 315 (HCJ (ChD)

BR Pub 22/07: Goods and Services Tax – Importers and input tax deductions

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

Taxation laws

This Ruling applies in respect of ss 20(3)(a)(ii), 75 and the definition of "invoice" in s 2 of the Goods and Services Tax Act 1985.

The Arrangement to which this Ruling applies

The Arrangement is the:

- importing of goods into New Zealand by registered persons for the purposes of making taxable supplies;
- levying of GST on those goods under s 12; and
- claiming of input tax deductions for that GST.

How the taxation laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- A registered person who accounts for GST on an invoice basis may use any one of the following documents issued by the New Zealand Customs Service (Customs) as an invoice to support a claim for a GST input tax deduction under s 20(3)(a)(ii):
  - an electronic import entry once the entry has been passed; or
  - a Deferred Payment Statement issued to an importer;
  - a cash statement; or
  - a manual invoice/statement.
- A registered person who accounts for GST on an invoice basis can claim an input tax deduction when an invoice is issued to them or when payment is made to Customs, whichever is earlier.
- A registered person who claims an input tax deduction based on one of the above types of invoice must keep the invoice as part of their record-keeping obligations under s 75(3).
- If the invoice does not include details of the imported goods, the registered person must also keep evidence of the imported goods (such as an import entry) as part of their record-keeping obligations under s 75(3).

The period or tax year for which this Ruling applies

This Ruling applies to input tax deductions for GST collected by Customs on goods imported into New Zealand on and following 9 July 2022 for an indefinite period.

This Ruling is signed by me on 8 June 2022.

Grant Haley
Tax Counsel Lead, Public Advice and Guidance

Commentary on Public Ruling BR Pub 22/07

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 22/07 ("the Ruling").

Summary

1. Customs collects GST levied under s 12 on goods imported into New Zealand. A registered person who accounts for GST on an invoice basis can claim an input tax deduction under s 20(3)(a)(ii) when an invoice is issued to them or when payment is made to Customs, whichever is earlier. This raises the question: which of the documents that Customs issues are invoices?

2. The Commissioner considers that an electronic import entry is an invoice once the entry has been passed.[2] In addition, the following documents are invoices when issued:
   - Deferred Payment Statements issued to an importer;
   - cash statements; and
   - manual invoices/statements.
3. A registered person who claims an input tax deduction based on one of the above types of invoice must keep the invoice as well as evidence of the imported goods to meet their record-keeping obligations.

Background

4. BR Pub 22/07 replaces "BR Pub 06/03: Importers and GST input tax deductions",[3] which will be withdrawn with effect from 8 July 2022. BR Pub 06/03 replaced "Public Ruling BR Pub 97/10: Importers and GST input tax deductions"[4] which replaced "Public Ruling BR Pub 95/09: GST: Importers and input tax deductions".[5]
5. The Commissioner's view of how the Act applies, as set out in BR Pub 06/03, has not changed. However, changes to Customs and Excise legislation made it necessary to update BR Pub 06/03. The following are the main differences between BR Pub 06/03 and BR Pub 22/07:
   - BR Pub 06/03 applied to GST levied under the Customs and Excise Act (CEA) 1996. The CEA 2018 has now replaced the CEA 1996. BR Pub 22/07 applies to GST collected under the CEA 2018.
   - The Commentary has been updated to reflect current systems and processes for lodging import entries.
   - The Ruling now also covers:
     - situations where Customs issues a manual invoice/statement; and
     - record-keeping obligations.

Claiming input tax deductions for import GST

6. The following analysis briefly summarises the requirements for an importer to claim an input tax deduction for import GST. It then explains when each of the four types of documents from Customs meets the criteria to be an invoice.

Input tax deduction available when invoiced by Customs

7. GST is levied and paid on goods imported into New Zealand (s 12(1)). Registered persons who account on an invoice basis are permitted to claim input tax on GST levied under s 12 when an invoice is issued or payment is made, whichever occurs earlier (s 20(3)(a)(ii)).
8. Unlike other claims for input tax deductions, importers are not required to hold tax invoices to support their claims. This is because Customs does not make any supplies when it is levying GST on goods imported into New Zealand, and so is not required to issue tax invoices under s 24.
9. Registered persons who account for tax payable on a payments basis or a hybrid basis cannot claim an input tax deduction until they have paid the GST to Customs. Therefore, this Ruling does not affect them.

An invoice is a document notifying an obligation to pay

10. An "invoice" is a document notifying an obligation to make payment (s 2). "Document" is widely defined to include information in both physical and electronic forms (s 3 of the Tax Administration Act 1994). "Notify" has its ordinary dictionary meaning of "to give notice to –, to inform" (*Shell New Zealand Holding Co. Ltd v CIR*[6]).
11. Four different types of documents issued by Customs can be used as "invoices" to claim an input tax deduction:
    - an electronic import entry once the entry has been passed; or

[2] The entry has been passed when Customs notifies the importer that the entry has been passed and allowed the goods to be released to the importer.

[3] "BR Pub 06/03: Importers and GST input tax deductions", *Tax Information Bulletin* Vol 18, No 6 (July 2006): 5.

[4] BR Pub 97/10: Importers and GST input tax deductions", *Tax Information Bulletin* Vol 9, No 11 (November 1997): 11.

[5] BR Pub 95/09: GST: Importers and input tax deductions", *Tax Information Bulletin* Vol 7, No 7 (January 1996): 15.

[6] *Shell New Zealand Holding Co. Ltd v CIR* (1994) 16 NZTC 11,163 (CA).

- a Deferred Payment Statement issued to an importer; or
- a cash statement; or
- a manual invoice/statement.

An electronic import entry is an "invoice" when entry passed

12. The Court of Appeal in *Shell* considered whether an import entry is an "invoice" under s 2. The central issue in the case was whether an importer, with a deferred payment arrangement, could claim an input tax deduction when Customs passed the import entry[7] or whether they had to wait until Customs sent a Deferred Payment Statement.
13. Under the law at the time, Customs entries were physical documents that a Customs officer stamped to pass the entry. The Court of Appeal noted that an "invoice" is "a document notifying an obligation to make payment". The import entry form was prescribed by Customs and contained relevant information such as a description of the goods, various information relevant to determining the customs value of the goods, GST data, the "Total Value for Duty", "Total Duty", "Total GST" and "Total Payable".
14. The court held that when the goods were entered, this constituted the duty as a debt due to the Crown. Therefore, the court considered the point at which the Customs officer signed the Customs import entry form to be notice to the importer of the obligation to make payment. A copy of the form was given to the importer when the entry was passed. It did not matter that an importer with deferred payment terms did not have to pay the debt immediately. As a result, the Customs import entry form satisfied the definition of "invoice" when the entry was passed.

An electronic import entry is analogous to the physical version

15. The nature of import entries has changed since *Shell* was decided. The Customs (Import Entry WCO Message) Rules 2013 require import entries to be lodged and cleared electronically.
16. GST on imported goods is a debt due to the Crown when goods are imported into New Zealand (s 100 and s 5, definition of "duty" of the CEA 2018). The importer makes an assessment of the GST payable on the goods when they make an entry for the goods (s 111 of the CEA 2018).
17. The payment obligation is triggered when Customs passes the entry for home consumption. For importers on deferred payment terms, passing the entry for home consumption debits the importer's deferred payment account (reg 24 of Customs and Excise Regulations 1996). For importers not on deferred payment terms, the GST becomes payable immediately (s 122 of the CEA 2018).
18. The information received on the electronic version of an import entry has not changed materially from the information received through the manual entry. The electronic entry shows the total duty, total GST and total payable. It identifies the supplier and the recipient of the goods and services, and describes the goods supplied with a detailed coding system. Therefore, the electronic entry document contains the information that the Court of Appeal in *Shell* thought necessary to establish and identify the Customs duty and GST that the importer owed to the Crown.
19. Customs notifies the importer or customs broker (as agent for the importer) when the entry is passed. This notification is the equivalent of a Customs officer signing and stamping a physical entry. When this notification occurs, the import entry meets the requirements for an "invoice" and the importer is entitled to claim an input tax deduction under s 20(3)(a)(ii). The importer or customs broker can access the import entry in Trade Single Window.[8]

A Deferred Payment Statement issued to an importer is an "invoice"

20. Customs operates an optional deferred payment scheme for importers. Under the scheme, Customs issues a Deferred Payment Statement for the duty importers owe on all the goods they import during a particular month. Payment is due on the 20th of the following month.
21. The Deferred Payment Statement is created from the information contained in the electronic entry. It itemises the GST payable for each entry as well as the total payable for the month. Consequently, a Deferred Payment Statement meets the definition of "invoice" and an importer can use it to support an input tax deduction.

[7] If Customs "passed" the entry, it deemed the goods to be entered and allowed the goods to be released to the importer.

[8] Trade Single Window is an electronic channel for submitting information to, and receiving responses from, border agencies.

A cash statement is an "invoice"

22. If an importer is not on the deferred payment scheme (or is not using a customs broker's deferred account), Customs issues a cash statement when an entry has been passed. The importer must pay duty before the imported goods are released.
23. The cash statement is created from the information contained in the electronic entry document and includes the amount of GST payable for the entry. Consequently, a cash statement meets the definition of "invoice" and an importer can use it to support an input tax deduction.

A manual invoice/statement that Customs issues is an "invoice"

24. Sometimes Customs may issue an importer with a manually generated invoice/statement. This can occur, for example, when GST is payable on imported goods that do not require an import entry.
25. A manual invoice/statement includes the amount of GST payable to Customs for the imported goods. Consequently, a manual invoice/statement meets the definition of "invoice" and an importer can use it to support an input tax deduction.

Importers must meet their record-keeping obligations

Importers must keep invoices as part of their records

26. Section 75(3) requires registered persons to keep certain records for at least 7 years after the end of the taxable period to which they relate. "Records" include "invoices" (s 75(1)). As well as the specific records listed in s 75(2), a registered person must keep "records that are sufficient to enable ready ascertainment by the Commissioner or an officer authorised by the Commissioner of the registered person's liability to tax".
27. Where an importer has claimed an input tax deduction based on the existence of an "invoice" from Customs, they must keep that invoice as a record under s 75(3). For an import entry, this can be stored electronically in Trade Single Window as long as the importer (or their agent) can access the import entry and provide it to Inland Revenue if requested. For importers using the services of a customs broker, it is not sufficient to keep an invoice or statement the broker has issued.

Importers must keep evidence of the imported goods

28. Deferred Payment Statements and cash statements do not include details of the imported goods. Therefore, importers using a Deferred Payment Statement or cash statement as an invoice will also need to keep the import entries or other records showing details of the imported goods.

Examples

29. The following examples show how the law applies.

Example 1: Electronic import entry

Riti's Fine Autos Ltd (RFAL) imports and sells European cars. It is registered for GST, accounts for tax payable on an invoice basis and files GST returns on a two-monthly basis. RFAL imports cars worth $300,000 on 28 September. It uses the services of customs broker Zip It Through Ltd (ZIT) to import the vehicles. For each shipment of cars RFAL imports, ZIT enters the details of the cars, including their values, into Trade Single Window and submits an import entry to Customs.

Customs passes the entry and generates a delivery order message authorising release of the cars. Customs debits ZIT's deferred account for the amount of duty and GST owing. When this occurs, the cleared import entry in Trade Single Window becomes an invoice.

RFAL's taxable period ends on 30 September. It must provide a GST return for the months of August and September. RFAL will include an input tax deduction claim for the GST levied on the cars imported on 28 September.

RFAL only needs an invoice to substantiate the claim for an input tax deduction for the GST levied on the imported cars. It can claim the input deduction in the taxable period ending 30 September because the electronic import entry contains all the necessary details to be an invoice. RFAL does not need to delay the claim until ZIT receives its Deferred Payment Statement or pays the GST owing to Customs on RFAL's behalf.

Example 2: Deferred Payment Statement

Adam Muir imports vintage gramophones for sale in his antique shop in Epsom. He is registered for GST and accounts for tax payable on an invoice basis. Adam has a deferred payment account with Customs. At the end of each month, Customs sends Adam a Deferred Payment Statement listing his import entries for the month and the GST payable for the goods in each entry.

Adam could have used the individual import entries as invoices. However, Adam can instead claim an input tax deduction under s 20(3)(a)(ii) when he receives the Deferred Payment Statement. He does not need to wait until the following month when payment is due.

Adam needs to keep both the Deferred Payment Statement and evidence of the imported goods to meet his record-keeping obligations under s 75.

Example 3: Manual invoice/statement

Sarah Fumar is a cigar retailer. She is registered for GST and accounts for tax payable on an invoice basis. During a recent trip to Cuba, Sarah found some unique cigars that she could not source in New Zealand. Sarah purchased two boxes of cigars for the equivalent of NZ$300. She declared the goods to Customs at the airport when she returned to New Zealand. Customs issued Sarah with an invoice/statement showing GST payable of $180 and took possession of the cigars until she could arrange payment.

Sarah can claim an input tax deduction under s 20(3)(a)(ii) when Customs issues the invoice/statement. She does not need to wait until she has paid for the cigars. Sarah needs to keep the invoice to satisfy her record-keeping obligations under s 75.

Legislation

Goods and Services Tax Act 1985

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

2 Interpretation

…

document means a document as defined in the Tax Administration Act 1994

…

invoice means a document notifying an obligation to make payment

…

3A Meaning of input tax

(1) Input tax, in relation to a registered person, means—

(a) tax charged under section 8(1) on a supply of goods or services acquired by the person:

(b) tax levied under section 12(1) on goods entered for home consumption under the Customs and Excise Act 2018 by the person:

…

12 Imposition of goods and services tax on imports

(1) Notwithstanding anything in this Act, a tax to be known as goods and services tax shall be levied, collected, and paid in accordance with the provisions of this section at the rate of 15% on the importation of goods (not being fine metal) into New Zealand, being goods that are—

(a) entered therein, or delivered, for home consumption under the Customs and Excise Act 2018; or

(b) entered for delivery to a manufacturing area licensed under section 59 of the Customs and Excise Act 2018; or

(c) before their entry, or delivery, for home consumption or, as the case may be, entry for delivery to a manufacturing area licensed under section 59 of the Customs and Excise Act 2018, dealt with in breach of any provision of the Customs and Excise Act 2018,—

by reference to the value of the goods as determined under subsection (2).

…

20 Calculation of tax payable

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

…

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

(a) in the case of a registered person who is required to account for tax payable on an invoice basis pursuant to section 19, the amount of the following:

…

(ii) input tax invoiced or paid, whichever is the earlier, pursuant to section 12 during that taxable period:

…

75 Keeping of records

(1) For the purposes of this section, the term **records** includes books of account (whether contained in a manual, mechanical, or electronic format) recording receipts or payments or income or expenditure, and also includes vouchers, bank statements, invoices, tax invoices, credit notes, debit notes, receipts, and such other documents as are necessary to verify the entries in any such books of account.

(2) Without limiting the generality of subsection (1), the records required to be kept and retained, pursuant to subsection (3), shall contain—

(a) a record of all goods and services supplied by or to that registered person showing the goods and services, and the suppliers or their agents, in sufficient detail to enable the goods and services, the suppliers, or the agents to be readily identified by the Commissioner, and all invoices, tax invoices, credit notes, and debit notes relating thereto; and

(b) the charts and codes of account, the accounting instruction manuals, and the system and programme documentation which describes the accounting system used in each taxable period in the supply of goods and services; and

(c) any list required to be prepared in accordance with section 19B(3) or section 78B(7).

(3) Subject to subsections (4) to (7), every registered person must keep, for a period of at least 7 years after the end of the taxable period to which they relate, the records listed in subsection (2) and records that are sufficient to enable ready ascertainment by the Commissioner or an officer authorised by the Commissioner of the registered person's liability to tax.

…

Tax Administration Act 1994

31. The relevant provision in the Tax Administration Act 1994 is as follows.

3 Interpretation

...

document means—

(a) a thing that is used to hold, in or on the thing and in any form, items of information:

(b) an item of information held in or on a thing referred to in paragraph (a):

(c) a device associated with a thing referred to in paragraph (a) and required for the expression, in any form, of an item of information held in or on the thing

...

Customs and Excise Act 2018

32. The relevant provisions in the Customs and Excise Act 2018 are as follows.

5 Definitions for Act

...

duty means any of the following:

...

(e) a duty or tax imposed by section 12 of the Goods and Services Tax Act 1985:

...

75 Entry of imported goods

(1) Goods that are imported, or are to be imported, must be entered by the importer—

(a) in the way prescribed by the chief executive's rules; and

(b) within the prescribed time or any additional time that the chief executive allows.

...

100 Duty on imported goods is debt owed to the Crown

(1) The duty on all imported goods is a debt—

(a) due to the Crown immediately on importation of the goods; and

(b) owed by the importer or importers of the goods; and

(c) recoverable by the chief executive (on behalf of the Crown) in any court of competent jurisdiction.

...

111 Entry is assessment of duty by importer or licensee or owner

(1) An entry for goods made under this Act is an assessment by the importer or licensee or owner (as the case may be) of the duty payable in respect of those goods.

...

122. Time for payment of duty on imported goods: general rule

(1) Except as otherwise provided in this Act, the duty on imported goods must be paid to Customs when—

(a) the goods have been entered in accordance with section 75 and the entry has been passed for home consumption; or

(b) the goods have been entered in accordance with section 75 for removal to a manufacturing area; or

(c) the goods have been wrongfully landed, or otherwise wrongfully dealt with, without having been entered in accordance with section 75; or

(d) an offence under this Act has been committed in respect of the goods.

...

Customs and Excise Regulations 1996

33. The relevant regulations in the Customs and Excise Regulations 1996 are as follows.

23 When entry of imported goods deemed to be made

An entry of goods to which section 75(1) of the Act applies is deemed to have been made for the purposes of the Act,—

(a) in the case of an entry made by means of an electronic message, on the date and at the time that the JBMS (as defined in section 302(4) of the Act) generates a lodgement number in respect of the receipt of that message; and

(b) in any other case, when the entry has been received by the Customs.

24 Passing of entry of imported goods

(1) An entry of goods to which section 75(1) of the Act applies is deemed to have been passed in accordance with the Act,—

(a) in the case of an entry for home consumption, when the JBMS (as defined in section 302(4) of the Act) debits the importer's deferred payment account, or raises a cash account in respect of the duty payable; and

(b) in the case of an entry of goods deemed to have been made in accordance with regulation 26, when entry is deemed to have been made according to that regulation; and

(c) in any other case, when a delivery order message is generated by the Customs.

References

Expired rulings

"Public Ruling BR Pub 06/03: Importers and GST input tax deductions", *Tax Information Bulletin* Vol 18, No 6 (July 2006): 5. **https://www.taxtechnical.ird.govt.nz/tib/volume-18---2006/tib-vol18-no6**

"Public Ruling BR Pub 97/10: Importers and GST input tax deductions", *Tax Information Bulletin* Vol 9, No 11 (November 1997): 11. **https://www.taxtechnical.ird.govt.nz/tib/volume-09---1997/tib-vol9-no11**

"Public Ruling BR Pub 95/09: GST: Importers and input tax deductions", *Tax Information Bulletin* Vol 7, No 7 (January 1996): 15. **https://www.taxtechnical.ird.govt.nz/tib/volume-07---1995-1996/tib-vol7-no7**

Case references

Shell New Zealand Holding Co. Ltd v CIR (1994) 16 NZTC 11,163

Legislative references

Goods and Services Tax Act 1985, ss 2 (definitions of "document" and "invoice"), 3A, 12, 20(3), 75

Tax Administration Act 1994, s 3 (definition of "document")

Customs and Excise Act 2018, ss 5 (definition of "duty"), 75, 100, 111, 122

Customs and Excise Regulations 1996, regs 23, 24

Notice of Withdrawal of Public Ruling BR PUB 06/03

1. This is a notice of withdrawal of a public ruling made under section 91DE of the Tax Administration Act 1994.
2. Public Ruling BR Pub 06/03 Importers and GST input tax deductions applies from 1 April 2005 for an indefinite period.
3. Public Ruling BR Pub 06/03 is withdrawn on 8 July 2022.

BR Pub 06/03 is being withdrawn due to changes to the Customs and Excise legislation and the relevant systems used by the New Zealand Customs Services (Customs) to process imports. BR Pub 06/03 applies up to, and including, 8 July 2022.

A new replacement public ruling, *BR Pub 22/07: Goods and Services Tax – Importers and input tax deductions* is being published with effect from 9 July 2022 for an indefinite period. This ruling refers to the Customs and Excise Act 2018 and to the current systems and process for lodging import entries. It also covers situations where Customs issues a manual invoice/statement and record keeping obligations.

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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 22/03: GST – Customs brokers and GST levied by Customs

Question

Can a customs broker treat GST they pay to the New Zealand Customs Service (Customs) on behalf of their importer clients as part of their taxable activity when accounting for GST?

Answer

No. GST a customs broker pays to Customs on behalf of an importer client relates to the importer's taxable activity, not the customs broker's taxable activity.

The customs broker cannot claim an input tax deduction for GST they pay to Customs on behalf of the importer client. This is because the customs broker did not acquire the imported goods for use in their own taxable activity.

The customs broker also cannot issue any documentation (for example a tax invoice) claiming to charge GST when they ask the importer to reimburse them for the GST they have paid to Customs. This is because the request for reimbursement is not a request for payment for a taxable supply the customs broker has made.

Explanation

1. Customs brokers (also referred to as customs agents) assist both importers and exporters in clearing their goods through Customs. Customs brokers may also be freight forwarders. A freight forwarder arranges transport for goods being imported or exported from New Zealand.
2. An importer would generally engage a customs broker to:
   - review documents relevant to the goods they are importing (including invoices and shipping documentation) to enable a Customs entry to be prepared;
   - as part of preparation of the Customs entry, help the importer assess their duty liability by calculating the Customs value of the goods, determining the classification of the goods under the Tariff and identifying any applicable duty concessions;
   - lodge the import entry;
   - act as the initial point of contact for the importer if further interaction with Customs regarding the goods is required; and
   - in some cases, pay GST to Customs on behalf of the importer (often by way of the customs broker's deferred account).

Input tax deductions

3. Customs collects GST on the importation of goods (not including fine metal) into New Zealand.
4. A registered person who enters goods for home consumption under the Customs and Excise Act 2018 is allowed an input tax deduction for GST that Customs collects, provided the imported goods are used for, or are available for use in making taxable supplies, other than:
   - delivering the goods to a person in New Zealand; or
   - arranging or making it easier to deliver the goods to a person in New Zealand.
5. It is the importer who enters the goods for home consumption and uses the goods in making taxable supplies. Therefore, it is the importer who can claim an input tax deduction for the GST paid to Customs.
6. The customs broker cannot claim an input tax deduction for GST they pay to Customs on behalf of an importer client, for the following reasons:
   - The customs broker does not pay the GST that Customs collects on their own account. They pay it on behalf of the importer.

- The customs broker is not the person who enters the goods for home consumption. To the extent they arrange for this to happen, the customs broker is merely acting as an agent for the importer.
- The customs broker does not use the goods for making their taxable supplies. To the extent that the customs broker is also a freight forwarder, the delivery of the goods is not considered a use in making taxable supplies.

Agency

7. Certain rules allow an agent acting for another person (the principal) to be treated as receiving the supply of goods or services in limited situations. These rules allow the agent, rather than the principal, to claim an input tax deduction.
8. While a customs broker acts as an agent for an importer, these provisions will not usually apply to a customs broker. This is because these rules apply only where an agent receives a supply of goods on behalf of someone else. A customs broker does not act as agent for the importer for the supply of the goods. They merely act as agent for the importer in taking the steps necessary to clear the goods through Customs.

Charging GST

9. GST is charged on the supply in New Zealand of goods and services by a registered person in the course or furtherance of a taxable activity.
10. A customs broker will usually be a registered person carrying on a taxable activity in New Zealand. However, that does not mean that they can charge GST on all payments made to them.
11. A customs broker should charge GST on their supplies of customs broking services. However, when a customs broker requests reimbursement for the GST they paid to Customs on behalf of an importer, they do not charge GST to the importer. This is because the reimbursement for the GST they paid to Customs is not for a taxable supply that the customs broker made. The customs broker also cannot issue any documentation (for example a tax invoice) claiming to charge GST on the request for reimbursement.

Bad debts

12. A person who has issued a tax invoice for a supply, and returned the GST charged, is entitled to claim an input tax deduction where an amount owing in relation to that supply is written off as a bad debt.
13. However, this provision will not apply to allow a customs broker to claim an input tax deduction where an importer fails to reimburse the customs broker for GST they paid to Customs. This is because the GST they paid to Customs does not relate to the customs broker's taxable activity and the customs broker is only seeking reimbursement of the GST they paid to Customs. The customs broker is not, therefore, entitled to charge GST as if they have made a supply.

Example

14. The following example illustrates the above points.

Quick to Clear Ltd is a customs broker. It helps Hair Cuts R Us Ltd to clear a shipment of barber's chairs through Customs, including by arranging payment of the relevant levies and Customs GST of $1,000.

Quick to Clear Ltd cannot claim an input tax deduction for the $1,000 of GST it paid to Customs on behalf of Hair Cuts R Us Ltd. Hair Cuts R Us Ltd is the only person that is eligible to claim an input tax deduction for that amount.

Quick to Clear Ltd also cannot issue a tax invoice, or any other documentation, claiming to charge Hair Cuts R Us Ltd the $1,000 of GST paid to Customs.

Instead, Quick to Clear Ltd issues an invoice as follows:

Tax invoice:	
Customs broking services	$75.00
Plus GST	$11.25
Total fee	$86.25
Disbursements:	
Customs GST	$1,000.00
Import Entry Transaction Fee (incl GST)	$33.03
Biosecurity System Entry Levy (incl GST)	$26.45
Total amount payable:	$1,145.73

Hair Cuts R Us Ltd can claim an input tax deduction for the GST charged by Quick to Clear Ltd for their brokerage services. Hair Cuts R Us Ltd can also claim an input tax deduction for the Customs GST, and for GST paid on the import entry transaction fee and the biosecurity system entry levy.

References

Legislative references

Goods and Services Tax Act 1985 - ss 3A(1)(b), 12, 20(3) and (3C), 26 and 60

QB 22/04: GST – Importers and recalculated GST

Question

Can an importer who overpays GST to the New Zealand Customs Service (Customs) claim an input tax deduction for the whole of the GST paid?

Answer

Yes – Customs is prevented from refunding overpaid GST where the importer is a registered person who can claim an input tax deduction. Therefore, the proper mechanism for obtaining a refund of overpaid GST where the importer is a registered person is to claim an input tax deduction for the whole of the GST paid to Customs.

Explanation

15. GST is collected by Customs on the importation of goods (not including fine metal) into New Zealand.
16. A registered person who enters goods for home consumption under the Customs and Excise Act 2018 is allowed an input tax deduction for GST levied by Customs, provided the imported goods are used for, or are available for use in making taxable supplies, other than:
    - the delivery of the goods to a person in New Zealand; or
    - arranging or making easier the delivery of the goods to a person in New Zealand.
17. Customs has powers allowing them to refund a duty, including GST, where:
    - the chief executive is satisfied that duty has been paid in error, either of law or of fact
    - an importer pays duty on goods based on a provisional Customs value and subsequently amends the assessment and the final Customs value results in a lower amount of duty being payable than the importer has already paid
    - duty has been paid on imported goods and a lower rate of duty, or an exemption in respect of the goods, is subsequently approved under the Tariff Act 1988
    - the imported goods:
        - have been damaged, destroyed, pillaged, or lost, or have diminished in value or deteriorated in condition, prior to their ceasing to be subject to the control of Customs; or
        - are of faulty manufacture; or
        - have been abandoned to the Crown for destruction or any other form of disposal prior to their ceasing to be subject to the control of Customs.
18. However, Customs is not allowed to refund GST to any registered person in respect of goods imported for the purpose of carrying on that person's taxable activity if the person is entitled to make an input tax deduction in respect of the goods.
19. Therefore, where GST has been overpaid by a registered person, the proper mechanism is for the registered person to claim an input tax deduction for the whole of the GST paid to Customs. The registered person cannot claim the amount back from Customs or from their customs broker.
20. This issue will only arise if the GST has actually been paid to Customs. If, for example, GST has been wrongly calculated due to an error of law or fact, and that error is discovered prior to payment being made, the importer (or customs broker) should contact Customs to fix the error. In addition, this issue only arises for GST registered importers who can claim an input tax deduction. If the person cannot claim an input tax deduction Customs is allowed to refund any overpaid GST along with any other duty.

Examples

21. The following examples illustrate the above points.

Example 1 – Error of fact

Imports R Us Ltd imports a container of sports bags. It completes its Import Entry but makes a mistake in calculating the values, resulting in the values being much higher than they should have been. Imports R Us Ltd pays the Customs duties and GST based on the erroneous values. Subsequently, Imports R Us Ltd discovers the error and applies to have Customs amend the duties assessed.

Customs can refund the other duties that have been overpaid. However, Customs is unable to refund the overpaid GST. Instead, Imports R Us Ltd needs to claim an input tax deduction for the whole of the GST originally paid to Customs.

Example 2 – Amended provisional values

Big Time Imports Ltd imports a consignment of big brand shoes. It completes its Import Entry based on the provisional Customs value for the shoes and pays the Customs duties and GST accordingly. Big Time Imports Ltd also claims an input tax deduction for the GST paid to Customs.

At the end of the income year, Big Time Imports Ltd undertakes its annual transfer pricing calculations. Following these calculations the value of the shoes it imported is decreased. Big Time Imports Ltd can amend its assessment and request a refund from Customs for the overpaid duties. Customs is unable to refund the overpaid GST. However, as Big Time Imports Ltd has already claimed an input tax deduction for the full GST paid there is no need to make any further amendments for the GST paid.

References

Legislative References

Customs and Excise Act 2018 - ss 142 to 145

Goods and Services Tax Act 1985 – ss 3A(1)(b), 12, and 20(3) and (3C)

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 19/04 (KM 2022): Kilometre rates for the business use of vehicles for the 2022 income year

In accordance with s DE 12(4) the Commissioner is required to set and publish kilometre rates. These rates can be used to calculate expenditure claims for the business use of a motor vehicle. They may also be used by employers as a reasonable estimate for reimbursement of expenditure incurred by employees for the use of a private motor vehicle for business purposes. More information is available on the Inland Revenue website www.ird.govt.nz/ (search keywords "claiming vehicle expenses").

The rates set out below apply for the 2021/2022 income year for business motor vehicle expenditure claims. The tier one rates reflect an overall increase in vehicle running costs largely due to fuel costs.

The table of rates for the 2022 income year:

The Tier Two rate is for running costs only. Use the Tier Two rate for the business portion of any travel over 14,000 kms in a year.

Vehicle Type	Tier One Rate	Tier Two rate
Petrol or Diesel	83 cents	31 cents
Petrol Hybrid	83 cents	18 cents
Electric	83 cents	10 cents

These operational statements provide further information on the use of the kilometre rates:

- OS 19/04A: Commissioner's statement on using a kilometre rate for business running of a motor vehicle - deductions
- OS 19/04B: Commissioner's statement on using a kilometre rate for employee reimbursement of a motor vehicle.

TECHNICAL DECISION SUMMARIES

Technical decision summaries (TDS) are summaries of technical decisions made by the Tax Counsel Office. As this is a summary of the original technical decision, it may not contain all the facts or assumptions relevant to that decision. A TDS is made available for information only and is not advice, guidance or a "Commissioner's official opinion" (as defined in s 3(1) of the Tax Administration Act 1994). **You cannot rely on this document as setting out the Commissioner's position more generally or in relation to your own circumstances or tax affairs**. It is not binding and provides you with no protection (including from underpaid tax, penalty or interest).

TDS 22/05: Whether weathertightness payments by the Crown are subject to GST

Technical decision summary - Adjudication

Decision date | Te Rā o te Whakatau: 17 November 2021

Issue date | Te Rā Tuku: 30 March 2022

Subjects | Ngā kaupapa

GST: grants and subsidies

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

GSTA	Goods and Services Tax Act 1985
GST	Goods and Services Tax
Commissioner	Commissioner of Inland Revenue or CIR
WHRS Act	Weathertight Homes Resolution Services Act 2006
FAP	Financial Assistance Package scheme under the WHRS Act
TCO	Tax Counsel Office, Inland Revenue
MBIE or the Ministry	Ministry of Business, Innovation and Employment
CCS	Customer and Compliance Services, Inland Revenue

Taxation laws | Ngā ture take

Goods and Services Tax Act 1985

Facts | Ngā meka

1. The Taxpayer is a GST registered body corporate providing services to the unit owners in a large apartment block. The apartment block suffered weathertightness issues that required extensive remedial work.
2. In 2008 the Taxpayer lodged a claim under the Weathertight Homes Resolution Services Act 2006 (**WHRS Act**). In 2015 a settlement was negotiated with the Council and two other companies. A settlement agreement was entered into which was subject to the Taxpayer entering the Financial Assistance Package (**FAP**) scheme under the WHRS Act. The Crown was not a party to the settlement agreement.
3. Subsequently, the Taxpayer, the Crown (acting by and through the Ministry of Business, Innovation and Employment (**MBIE**)) and the Council entered the FAP Agreement. The FAP Agreement states there is no admission of liability by the Ministry and/or the Council. A clause in the agreement recorded that:

- the Ministry and the Council each agreed to pay 25% of the remedial costs initially capped at a total of $10 million (including GST); and
- the Ministry agreed that it was making the payment as part of the settlement of a dispute between the Taxpayer and other parties.

4. Subsequently, MBIE advised the Taxpayer that costs would not be capped at $10 million and this particular clause was deleted in a 2019 amendment to the FAP Agreement.
5. Since July 2017 there has been a series of Crown FAP payments. The Taxpayer included all these payments in monthly GST returns and paid GST output tax on them.

Issues | Ngā take

6. The issue considered in this dispute was:
   - whether the Crown FAP Payments received by the Taxpayer during the periods ended 30 September 2020 and 31 December 2020 were a "payment in the nature of a grant or subsidy" under s 5(6D) and consequently subject to GST.
7. The GST treatment of the Council's FAP contribution to the Taxpayer was not in issue.

Decisions | Ngā whakatau

8. TCO decided that:
   - the Crown FAP Payments to the Taxpayer are gratuitous payments to encourage or promote the repair of leaky buildings. Accordingly, the payments are in the nature of a grant or subsidy for the purposes of s 5(6D) of the Goods and Services Tax Act 1985 (GST Act). The Crown FAP payments are therefore deemed to be consideration for a supply under s 5(6D) of the GST Act.

Reasons for decisions | Ngā take mō ngā whakatau

Issue | Take: Whether the payments are in the nature of a grant or subsidy for the purposes of s 5(6D)

9. The issue was whether the payments received by the Taxpayer were a "payment in the nature of a grant or subsidy" under s 5(6D). If they were, then there is a deemed supply for consideration and the payments will be subject to GST.
10. Customer and Compliance Services, Inland Revenue (**CCS**) argued s 5(6D) applied because the Crown FAP payments were made without obligation to assist the Taxpayer to repair the property and this benefits both the Taxpayer and the wider public.
11. The Taxpayer argued the Crown FAP Payments were not payments in the nature of a grant or subsidy and s 5(6D) did not apply. The payments arose under the FAP Agreement and were, in form and substance, payments to settle any legal liability of the Crown (and possibly in part the legal liabilities of the Council). The payments were not made to assist or enable the Taxpayer to provide goods and services considered of public benefit in accordance with any Government objective.
12. Section 5(6D) deems any payment in the nature of a grant or subsidy made on behalf of the Crown to any person in relation to or in respect of their taxable activity to be consideration for a supply of goods and services by the person to whom or for whose benefit the payment is made. The supply is deemed to be in the course or furtherance of that person's taxable activity.
13. The key requirements for s 5(6D) are that there is a payment:
    - in the nature of a grant or subsidy
    - made on behalf of the Crown or by any public authority
    - made to a person (not being a public authority)
    - made in relation to or in respect of that person's taxable activity.
14. The parties agreed that the latter three requirements were met in relation to the Crown FAP Payments. The issue to be considered was the first bullet – whether the payment was in the nature of a grant or subsidy.

Payments in "the nature of a grant or subsidy" for the purposes of s 5(6D)

15. The GST Act provides an inclusive and non-exhaustive definition of a "payment in the nature of a grant or subsidy" in s 5(6E). Some specific payments are expressly included and others expressly excluded from the definition. None of the specific inclusions and exclusions were considered relevant in this case.

16. The common thread in the definitions is that there "is a gift or assignment of money by government or a public authority out of public funds to a private or individual or commercial enterprise deemed to be beneficial to the public interest."[1]

17. Case law indicates the focus is on the character of the payment from the payer's perspective, not its receipt in the hands of the payee, and recognises that a subsidy payment changes the nature of a contract from an ordinary commercial contract.[2] The Commissioner's previously published public guidance[3] has considered factors which may indicate that a payment is in the nature of a grant or subsidy, including where the payment is:
    - a gift, in the sense that there is no obligation to make it
    - a special assistance payment
    - to promote or encourage an industry or enterprise
    - out of public funds
    - beneficial to the public interest.

18. In summary, it was considered that the case law indicates a payment in the nature of a grant or subsidy is a gratuitous payment made by the Crown, out of public funds, to promote or encourage an industry or enterprise and that the payment is special assistance, beneficial to the public interest.[4]

19. The Taxpayer argued that the Crown FAP Payments were not the sort of payments Parliament envisaged as being subject to GST as payments in the nature of a grant or subsidy. Consequently, TCO considered the legislative background and concluded that the Government's intention was that GST would be payable on grants and subsidies received by a registered person in the course of their taxable activity. The recipients of these grants are supplying services to the Crown through the use to which they put the grant money they receive and the purpose of s 5(6D) is to make such payments subject to GST.

20. TCO concluded that the Crown FAP Payments were in the nature of a "grant or subsidy" because:
    - The payments were gratuitous payments by the Crown for the purpose of assisting with the cost of repairing the Taxpayer's property to remedy problems arising from it not being weathertight. The payments were gratuitous because the Crown was under no obligation to make the payments.[5]
    - The FAP Agreement does not acknowledge or otherwise create a duty of care and does not represent an admission of any form of liability by the Crown to the Taxpayer.
    - The Crown FAP Payments are special assistance payments, deemed to be beneficial to the public interest.
    - To the extent it is necessary to conclude that the repair of leaky homes is beneficial to the public interest, or enables the Taxpayer to provide services to members of the public at a concessionary price, this criterion is satisfied. This is because it is in public interest that these properties remain habitable by the homeowner and other New Zealanders in the future, and the homeowners were able to have their units repaired at a reduced cost.

GST treatment of compensation or settlement payments

21. The parties agreed that a compensation or settlement payment will not be a payment in the nature of a grant or subsidy. A payment for loss or damage is not consideration for a supply.

22. There is some crossover between the question of whether the Crown FAP Payments were gratuitous and whether the payments were compensation or settlement payments.

[1] Commissioner's public statement: "Application of GST to Government Grants and Subsidies" (*Tax Information Bulletin* Vol 3, No 1 (July 1991)). This wording is from the Canadian case, *GTE Sylvania Canada Ltd v R* [1974] 1 FCR 726.

[2] *Kena Properties Limited v Attorney-General* (2002) 20 NZTC 17,433 (PC); *Director-General of Social Welfare v De Morgan and anor* (1996) 17 NZTC 12,636 (CA).

[3] Interpretation Statement IS 3427 "Treaty of Waitangi Settlements – GST Treatment" (*Tax Information Bulletin* Vol 14, No 9 (September 2002)) and Interpretation Statement IS 3387: "GST Treatment of Court Awards and Out of Court Settlements" *Tax Information Bulletin* Vol 14, No 10 (October 2002).

[4] *Kena Properties Limited*; *De Morgan* (CA); *De Morgan and Anor* (1996) 17 NZTC 12,441 (HC); *Reckitt & Colman Pty Ltd v FCT* 4 ATR 501; *First Provincial Building Society Ltd v FCT*; *Case Q13* (1993) 15 NZTC 5,078 and *Placer Development Ltd v Commonwealth of Australia* (1969) 121 CLR 353.

[5] *Attorney-General v Body Corporate 200200 (Sacramento)* [2007] 1 NZLR 95 supports the view there is no duty of care on the Crown.

23. TCO considered the object of compensation is to financially restore the injured person to the position which he or she would have occupied had the breach not occurred.[6] Where physical damage to a building has occurred as a result of the negligence of a builder, designer or local authority, the primary measure of damages is the cost of the remedial work or reinstatement.[7]

24. Case law indicates that when determining whether a payment is a compensation payment and not consideration for a supply the emphasis is on the legal arrangements actually entered into and carried out. For a payment to be consideration for a supply the courts focus on whether there is a nexus between the supply and the consideration. No such nexus is established where the payment is a compensation or settlement payment. Further, a payment to settle a dispute and avoid litigation is not a "payment in the nature of a grant and subsidy" for the purposes of s 5(6D).[8]

25. The position in the Commissioner's guidance on the GST treatment of court awards and out of court settlements[9] is that a payment may be made for the purpose of settling a dispute or to compensate for a loss even where the payer does not accept any liability for the loss. This requires determination of whether the payment is for the purpose of compensating for a loss.

26. It was a pre-condition of the settlement of proposed litigation between the Taxpayer and the Council and two other companies (not including the Crown) that the Taxpayer enter into the Government's FAP scheme under the WHRS Act.

27. Upon entering into the FAP scheme the Taxpayer was required under s 125BA(2)(b) of the WHRS Act to discontinue the litigation it had commenced against the Council. Section 125BA makes no reference to the Crown.

28. Section 125G of the WHRS Act provides that claimants who enter into the FAP scheme may not name the contributing party (ie, in this case the Crown) or any additional contributing party as defendant in any civil proceedings. TCO considered the WHRS Act and legislative history and concluded that:

    - The purpose of s 125G of the WHRS Act (combined with the contribution criteria requiring a claimant who has commenced civil proceedings against the Council to discontinue those civil proceedings entirely) was to divert funds from taxpayers and the Council away from litigation towards the repair of the property.
    - The reason for the inclusion of the Crown (as a contributing party) in the immunity provided by s 125G was out of an abundance of caution and to ensure that the Crown preserve its position of not incurring liability for leaky homes which the courts have found does not extend to the Crown.

29. That the Crown had no liability for leaky homes was the understanding of the Honourable Maurice Williamson (Minister for Building and Construction) when the FAP Bill was being enacted in 2011. At the first, second, and third readings of the Bill the Minister emphasised that the Crown did not need to make any such payment to homeowners and referenced the failed court attempts to hold the Crown liable for leaky homes damages. This view is consistent with the case law.

30. The Court of Appeal has held that the Building Industry Authority (**BIA**) (replaced in November 2004 by the Department of Building and Housing which became part of MBIE in July 2012) had no duty of care to property owners of homes with monolithic cladding systems to exercise reasonable care in connection with its statutory responsibilities.[10] The Supreme Court followed this reasoning in confirming that the BIA was not under a duty of care to property owners.[11]

31. The courts have taken a different view when considering the liability of territorial authorities/councils to property owners.[12] In summary, the courts' approach effectively means that MBIE owes no duty of care to property owners facing weathertightness issues as there is insufficient causality between the MBIE and homeowners. However, local authorities can owe a duty of care to property owners.

32. TCO concluded that the payments were not compensation or settlement payments. This is because whether a payment is a grant or subsidy is determined from the point of view of the payer, and the Crown FAP Payments were not made to settle the dispute between the Taxpayer and the Council or any dispute between the Taxpayer and the Crown. While s 125G of the WHRSA provides immunity, this was included out of an abundance of caution and does not indicate that the Crown entered into the FAP Agreement to protect itself from liability.

[6] *Attorney-General v Geothermal Produce New Zealand Ltd* [1987] 2 NZLR 348 (CA).

[7] *Invercargill City Council v Hamlin* [1996] 1 NZLR 513.

[8] *CIR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 (CA); *New Zealand Refining Co Ltd v CIR* (1995) 17 NZTC 12,307 (HC).

[9] Interpretation Statement IS 3387: "GST Treatment of Court Awards and Out of Court Settlements" *Tax Information Bulletin* Vol 14, No 10 (October 2002).

[10] *Attorney-General v Body Corporate 200200 (Sacramento)* [2007] 1 NZLR 95.

[11] *North Shore City Council v Attorney-General* [2012] 3 NZLR 341.

[12] *North Shore City Council v Body Corporate 188529 (Sunset Terraces & Ors; North Shore City Council v Body Corporate 189855 (Byron Avenue) & Ors* [2011] 2 NZLR 289.

33. In response to particular arguments (including that the Crown FAP Payments and Council FAP payments should be treated as one overall FAP payment) TCO considered:
    - Upon entering into the FAP scheme the Taxpayer was obligated under s 125BA(2)(b) of the WHRS Act to discontinue the litigation it had commenced against the Council but s 125BA makes no reference to the Crown.
    - The Crown was not a party to the Settlement Agreement which settled the Taxpayer's claim for damages from the Council (and two other companies).
    - Whether a payment made is in the nature of a grant or subsidy is determined from the payer's point of view. It follows that the fact that the Taxpayer may not have reached a settlement in its dispute with the Council and two other companies in the absence of the Crown agreeing to pay 25% of the Approved Costs is not relevant in determining the nature of the Crown FAP Payments from the Crown's point of view.
    - The FAP scheme is not limited to homeowners who settled disputes with a territorial authority or council. The Crown may still contribute to the cost of repairs even if a council does not owe a duty of care to the claimant provided the claimant meets the other contribution criteria. For this reason it is not considered that the level of the Crown FAP Payments was to induce the Council and Taxpayer to settle their dispute.
    - The clause in the FAP Agreement recording MBIE's agreement that it was making payment as part of the settlement of the dispute was deleted by the 2019 amendment.
    - The 2019 amendment supports the view that the Crown FAP payment was not to secure settlement of the Taxpayer's dispute. The 2019 amendment effectively meant the Crown contribution to the remedial work would not be capped at $10 million but would instead be the actual costs and expenses the Taxpayer incurred. The Crown FAP Payments were increased at a point when the Taxpayer had already settled its dispute with the Council and the Taxpayer's legal rights to name the Crown in any future civil proceedings relating to the property was restricted. This supports the view that the nature of the Crown FAP Payments was a gratuitous payment to assist with the cost of repairing the Taxpayer's property to remedy problems arising from it not being weathertight.
    - The purpose of s 125G (combined with the requirement that a claimant who has commenced civil proceedings against the Council discontinue those proceedings) was to divert funds from the Taxpayer and the Council away from litigation towards the repair of the property. The inclusion of the Crown (as a contributing party) in the immunity provided by s 125G was out of an abundance of caution, namely, to ensure that the Crown preserve its position of not incurring liability for leaky homes which the courts have found does not extend to the Crown.
    - MBIE's annual report did not in TCO's view describe the Crown contributions under the FAP scheme as a payment to settle and manage litigation risk.

Consistency with Inland Revenue publications

34. The conclusion in this matter was considered to be consistent with the Commissioner's Statement on the GST treatment of MBIE leaky home payments.[13] That statement sets out the Commissioner's position that payments under the FAP scheme are not a payment in respect of any actual supply of goods and services made by the body corporate in return for that payment. The Commissioner considers that the payments are in the nature of a grant or subsidy from the Crown under s 5(6D) and are therefore deemed to be in response to a supply from the body corporate. As a result, these payments are subject to GST.
35. A GST registered body corporate which receives such payments is therefore obliged to include the GST component in its GST return and to pay for any net GST output tax. A body corporate which is not registered (and not liable to be registered) for GST is not obliged to account for GST.
36. TCO also considered the Commissioner's published guidance on Treaty of Waitangi settlements.[14] Treaty settlements are not subject to GST because the settlement payments are not "consideration" for the supply of any goods or services made by the relevant Māori claimant group to the Crown. The Commissioner considers a Treaty settlement payment made by the Crown to provide redress for historical wrongs that were breaches of the Treaty of Waitangi is not gratuitous or a gift as it was "occasioned by a moral, and possibly legal, obligation [on the Crown] to correct the wrong done".
37. This obligation to compensate for breaches of New Zealand's founding document can be contrasted to the weathertightness issue where the Crown had no duty of care to the Taxpayer and no moral obligation to compensate the Taxpayer for the loss suffered from owning a leaky building.

[13] Commissioner's Statement CS 20/05, "GST treatment of payments received by a GST registered body corporate from the Ministry of Business, Innovation and Employment under the Leaky Homes Financial Assistance Package", *Tax Information Bulletin* Vol 32, No 10 (November 2020) at pages 2-4.

[14] Interpretation Statement IS 3427 "Treaty of Waitangi Settlements – GST Treatment" (*Tax Information Bulletin* Vol 14, No 9 (September 2002)).

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TDS 22/07: Income tax, controlled foreign company, double tax agreement, shortfall penalties

Technical decision summary - Adjudication

Decision date | Te Rā o te Whakatau: 18 November 2021

Issue date | Te Rā Tuku: 1 June 2022

Subjects | Ngā kaupapa

Income tax: income under ordinary concepts; employment income; attributed controlled foreign company income

Double tax agreement: tax residency; dependent personal services

TAA: shortfall penalties

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

CCS	Customer & Compliance Services, Inland Revenue
CFC	Controlled foreign company
Commissioner or CIR	Commissioner of Inland Revenue
DTA	The Double Taxation Relief (United States of America) Order 1983
ITA	Income Tax Act 2007
LLC	Limited liability company
TAA	Tax Administration Act 1994
TCO	Tax Counsel Office
TRA	Taxation Review Authority
US	United States of America

Taxation laws | Ngā ture tāke

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

Facts | Ngā meka

1. The Taxpayer is a citizen of the United States of America (**US**) and therefore a tax resident of the US.
2. The Taxpayer was employed as CEO of a New Zealand company (**Company A**) under an employment agreement. The Taxpayer provided the CEO services through a company formed in the US (**the US LLC**) and a New Zealand company (**Company B**). The Taxpayer was the sole director and shareholder of both Company B and the US LLC.

3. Two service agreements were signed - one between Company A and Company B, and another between Company A and the US LLC. The terms of both management service agreements were that the Taxpayer was provided to Company A to act as its CEO in exchange for an annual remuneration.
4. During an investigation into the Taxpayer's tax affairs, Customer & Compliance Services, Inland Revenue (**CCS**) reviewed the bank accounts maintained by Company B. CCS noted many withdrawals from an account that they considered to be cash payments received by the Taxpayer or amounts used to pay the Taxpayer's private expenses. (These withdrawals from Company B will be referred to as **the disputed payments** in this TDS). These withdrawals included expenditure on accommodation, food and beverages, international airfares and cash withdrawals.
5. CCS also noted similar withdrawals from the US LLC's bank account which they considered to be cash payments received by the Taxpayer or used to pay for the Taxpayer's private expenses. CCS further identified a series of deposits into the US LLC's bank account which they considered to be remuneration received by the US LLC under the service agreement between the US LLC and Company A.
6. As a result of the investigation, CCS formed the following views, and issued a default assessment for the disputed income year accordingly:
    - The disputed payments were assessable income of the Taxpayer under s CA 1 (income under ordinary concepts) or alternatively under s CE 1 (employment income).
    - The US LLC was a controlled foreign company (**CFC**) for New Zealand income tax purposes and, therefore, the Taxpayer had attributed CFC income from the company.
    - The Taxpayer was a New Zealand tax resident under of the Double Taxation Relief (United States of America) Order 1983 (**DTA**) for the disputed income year and article 15 of the DTA gave New Zealand the sole right to tax the disputed payments.
    - The Taxpayer was liable to a gross carelessness shortfall penalty in relation to both the disputed payments and the attributed CFC income.
7. In their dispute documents, the Taxpayer contended that CCS's tax assessment and shortfall penalty assessment should be reduced to nil because they argued that:
    - The Taxpayer was a US tax resident and therefore was not required to file an income tax return in New Zealand. They argued that they had met their tax obligations by filing a personal income tax return in the US, which included the US LLC's business income.
    - CCS incorrectly treated deductible business expenditure of Company B as private expenditure of the Taxpayer and that any disallowed amounts should have been assessed as income of Company B. CCS failed to take a fair, balanced and common-sense approach and, therefore, their assessment was invalid.
    - The US LLC was not a CFC for New Zealand income tax purposes as the DTA took precedence.
    - The Taxpayer was not liable to pay a shortfall penalty because they returned all their income in the US as required.

Issues | Ngā take

8. The issues and sub-issues considered in this dispute were:
    - Procedural issues:
        - Whether the Taxpayer discharged their onus of proof by showing that CCS's assessment was arbitrary and invalid.
        - Whether there was a breach of the Taxpayer's human rights when CCS took the Taxpayer's marital status into account to determine their residency under the DTA.
    - Assessable income:
        - Whether the disputed payments were income of the Taxpayer under s CA 2(1) as income under ordinary concepts.
        - Whether the disputed payments were employment income of the Taxpayer under s CE 1(1).
        - Whether the taxpayer had attributed CFC income from the US LLC under ss CQ 1 and CQ 2.
    - New Zealand's taxing rights under the DTA:
        - Whether the Taxpayer was a tax resident of New Zealand or the US under article 4 of the DTA.
        - Whether New Zealand had the right to tax the disputed payments under article 15 of the DTA.

- Shortfall penalties:
  - Whether the Taxpayer was liable for a gross carelessness shortfall penalty under s 141C of the Tax Administration Act 1994 (**TAA**).
  - Alternatively, whether the Taxpayer was liable for a shortfall penalty for not taking reasonable care under s 141A of the TAA.
  - Whether the Taxpayer was eligible for a reduction in any shortfall penalty payable under s 141FB of the TAA.

Decisions | Ngā whakatau

9. The Tax Counsel Office (**TCO**) decided that:
   - Procedural issues:
     - The Taxpayer did not discharge their onus of proof as CCS's assessment was not arbitrary or invalid.
     - The breach of human rights claim was a procedural matter that should be addressed by the Taxation Review Authority (**TRA**) or a court. However, it was noted that the Taxpayer's marital status was relevant to determining the tax residency of the Taxpayer.
   - Assessable income:
     - The disputed payments were income under ordinary concepts under s CA 1(2).
     - The disputed payments were employment income under s CE 1(1).
     - The Taxpayer did not have attributed CFC income from the US LLC under ss CQ 1 and CQ 2. However, the Taxpayer may have attributed income under ss GB 27-29.
   - New Zealand's taxing rights under the DTA:
     - The Taxpayer was treated as a New Zealand resident for the purposes of the DTA.
     - The effect of article 15(1) of the DTA was that New Zealand had an exclusive right to tax the income that the Taxpayer derived from Company B.
   - Shortfall penalties:
     - The Taxpayer was liable for a gross carelessness shortfall penalty under s 141C of the TAA.
     - Alternatively, if it was subsequently found by the TRA or a court that the requirements of the gross carelessness shortfall penalty were not satisfied, the Taxpayer was liable for a shortfall penalty for not taking reasonable care under s 141A of the TAA.
     - The Taxpayer was not eligible for a reduction in the shortfall penalty under s 141FB of the TAA because the shortfall penalties imposed in a previous dispute came within the definition of "disqualifying penalty".

Reasons for decisions | Ngā take mō ngā whakatau

Issue 1 | Take tuatahi: Procedural issues

Onus and standard of proof

10. The onus of proof in civil proceedings[1] is on the taxpayer, except for shortfall penalties for evasion or similar act, or obstruction.[2] The taxpayer must prove that an assessment is wrong, why it is wrong, and by how much it is wrong.[3]
11. The standard of proof in civil proceedings is the balance of probabilities.[4] This standard is met if it is proved that a matter is "more likely than not".[5] Whether the Taxpayer has discharged the onus of proof is considered in the other issues.

[1] Challenge proceedings (ie, the proceedings that would follow if this dispute proceeds to the TRA or a court) are civil proceedings.

[2] Section 149A(2) of the TAA.

[3] *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA); *Beckham v CIR* (2008) 23 NZTC 22,066 (CA).

[4] Section 149A(1) of the TAA; *Yew v CIR* (1984) 6 NZTC 61,710 (CA); *Birkdale Service Station Ltd v CIR* (1999) 19 NZTC 15,493 (HC); *Case X16* (2005) 22 NZTC 12,216; *Case Y3* (2007) 23 NZTC 13,028.

[5] *Miller v Minister of Pensions* [1947] 2 All ER 372, 374.

12. An assessment made by the Commissioner cannot be arbitrary. She must make the best judgment she can on the information in her possession as to the amount of taxable income and the amount of tax payable. In some cases, a taxpayer may be able to discharge the onus of proof by showing that the assessment is arbitrary or demonstrably unfair.[6]
13. The Taxpayer argued that CCS acted in an arbitrary and unfair way when they characterised the disputed payments, and because of this CCS's assessment was invalid. The Taxpayer contended that CCS assessed withdrawals that were clearly business expenses and effectively treated everything in Company B's account as private expenditure, thereby ignoring the business that was being carried on.
14. It was unclear whether the Taxpayer was arguing that CCS's characterisation of the withdrawals from the US LLC was also arbitrary and unfair. TCO, therefore, took a conservative approach and considered CCS's treatment of the withdrawals from both Company B and the US LLC.
15. TCO considered the information that CCS took into account and the methodology they adopted when they made the assessment and determined the assessment was not arbitrary or demonstrably unfair, for these reasons:
    - The methodology CCS adopted involved an honest exercise of judgment and the consideration of relevant facts and information, including the Taxpayer's relationship with the companies (ie, the Taxpayer performed services on their behalf) and where the Taxpayer was residing at the time the expenditure was incurred, or withdrawal was made.
    - CCS reviewed bank statements for both companies and made a judgment as to whether each of the withdrawals from the accounts were private expenditure or deductible business expenditure. CCS categorised each withdrawal into wholly private, wholly deductible or partly deductible.
    - A review of these categories did not suggest CCS treated obvious business expenditure as private or otherwise gave no consideration to how each withdrawal should be treated.
    - CCS gave the Taxpayer the opportunity to review the treatment of the withdrawals and to provide evidence if they disagreed, but the Taxpayer did not provide such evidence.
    - CCS assessed on the basis of the information they had, and they were not required to seek further information from other sources.[7]
16. Consequently, it was also considered that the Taxpayer did not discharge the onus of proof that CCS's assessment was invalid.

The Taxpayer's human rights

17. The Taxpayer argued that their marital status was irrelevant to the dispute and argued that it was offensive, and in breach of their human rights under New Zealand law and the International Convention on Human Rights, that CCS considered it was relevant.
18. TCO considered that when it adjudicates a dispute, TCO must determine a taxpayer's tax liability according to law. Correctness is the sole criterion for determining tax liability.[8] Any claimed grounds of error, illegality or invalidity can be addressed by the TRA or a court if the dispute proceeds to challenge stage.[9]
19. Accordingly, the adjudication was only concerned with the Taxpayer's liability for tax.
20. However, TCO observed that the Taxpayer's marital status was relevant to assess whether the Taxpayer had a stronger personal and economic relation with New Zealand than the US. This is addressed in Issue 3.

Issue 2 | Take tuarua: Assessable income

21. The issue was whether the Taxpayer derived assessable income under the ITA during the disputed income year.
22. CCS argued that Company B paid private expenses on the Taxpayer's behalf and this amount was either income under ordinary concepts that was assessable under s CA 1(2), or it was employment income that was assessable under s CE 1. Further, CCS argued that the US LLC was a CFC and its net income for the disputed income year was attributed CFC income of the Taxpayer under s CQ 2.
23. The Taxpayer argued that CCS incorrectly treated deductible business expenditure of Company B as private expenditure of the Taxpayer and that the US LLC was not a CFC for New Zealand income tax purposes.

[6] *Lowe v CIR* (1981) 5 NZTC 61,006 (CA); *CIR v Canterbury Frozen Meat Co Ltd* (1994) 16 NZTC 11,150 (CA); *CIR v New Zealand Wool Board* (1999) 19 NZTC 15,476 (CA).

[7] *CIR v New Zealand Wool Board* at 15,489.

[8] *CIR v Michael Hill Finance* (NZ) Ltd [2016] NZCA 276, (2016) 27 NZTC 22-056 at [29] and [43].

[9] *Tannadyce Investments Ltd v CIR* [2011] NZSC 158, (2011) 25 NZTC 20-103 at [55].

Income under ordinary concepts

24. Section CA 1(2) provides that an amount is income of a person if it is their income under ordinary concepts.
25. The key principles on what income under ordinary concepts means are:
    - Income is something that "comes in".[10]
    - Even if a taxpayer does not directly receive the money, it would be considered the taxpayer's income if it had been dealt with in the taxpayer's interest or on their behalf.[11]
    - Whether or not a particular receipt is income depends on its quality in the hands of the recipient.[12]
    - Regularity or recurrence indicates that payments may become part of the receipts that the recipient may depend on for living expenses.[13] However, regularity alone is not determinative – a single payment may also be income.[14]
    - Consideration must be given to the relationship between payer and payee.[15]
    - The purpose of any payments made must be considered.[16]
26. TCO first addressed CCS's characterisation of the disputed payments.
27. The withdrawals that were characterised as private expenditure by CCS included expenditure for accommodation, food and beverages, international airfares, foreign currency fees and overseas withdrawal fees, general expenses and cash withdrawals.
28. In treating these withdrawals as private expenditure, CCS relied on the nature of the expenditure, the fact that the Taxpayer was the only person who had control over Company B's bank account, and the fact that the Taxpayer did not maintain a separate bank account in their own name.
29. TCO concluded that the Taxpayer did not satisfy the onus of proof that CCS's characterisation of these withdrawals as private expenditure was wrong, or by how much it was wrong, for these reasons:
    - The Taxpayer was a New Zealand tax resident under the DTA (discussed further in Issue 3). Consequently, TCO did not accept the Taxpayer's argument that they were in New Zealand for business purposes only and that the expenditure incurred in New Zealand was business related. The Taxpayer did not provide any evidence to suggest the expenditure was business expenses.
    - There was no evidence to suggest that Company B had any service agreements that the Taxpayer was working on while outside of New Zealand or evidence of any overseas clients. The Taxpayer did not substantiate their argument that the travel expenditure and expenditure incurred outside of New Zealand were business related.
    - The Taxpayer did not provide any evidence which would show the other general expenses and cash withdrawals had a nexus with Company B's income earning activities. The Taxpayer did not prove that CCS mistakenly treated business expenditure as private expenditure.
30. Having concluded that the Taxpayer did not prove CCS's treatment of the disputed payments was wrong, TCO went on to conclude the disputed payments were the Taxpayer's income under ordinary concepts, and were assessable under s CA 1(2) because:
    - The disputed payments were something which comes in. The payments that were paid to third parties or directly to the Taxpayer (in the case of cash withdrawals) were received by the Taxpayer as the Taxpayer was the only person who controlled Company B's bank account and was, therefore, the person who effected the payments. In any case, s BD 3(4) would treat the payments made to third parties as income of the Taxpayer as it was dealt with in the Taxpayer's interest or on their behalf.
    - Company B was incorporated for the purpose of using it as a vehicle to perform the Taxpayer's personal services. The Taxpayer's exertions were the means by which Company B generated its income. It was considered that the disputed payments had the quality of a return received by the Taxpayer for their exertions.

[10] *A Taxpayer v CIR* (1997) 18 NZTC 13,350 (CA) at 13,335.
[11] Section BD 3(4); *Dunn v CIR* (1974) 1 NZTC 61,245 (NZSC) at 61,248-61,249.
[12] *Reid v CIR* (1995) 7 NZTC 5,176 (CA) at 5,183.
[13] *Reid v CIR*.
[14] *FCT v Hyteco Hiring Pty Ltd* 92 ATC 4694 at 4,700.
[15] *Reid v CIR*.
[16] *Reid v CIR*.

- Evidence showed that the payments were recurrent. Further, as the payments were applied to meet the Taxpayer's private expenses, they were a part of the receipts upon which the Taxpayer depended on for their living expenses.
- The Taxpayer was Company B's sole shareholder and director, and the Taxpayer performed services which generated Company B's income.
- The purpose of the payments was to pay the Taxpayer's private expenses.

Employment income

31. CCS argued that if the disputed payments were not income under ordinary concepts, they were employment income under s CE 1.
32. Section CE 1(1) states that amounts derived by a taxpayer in connection with their employment or service are income of that taxpayer. Employment income includes:
    - Salary, wages, or allowances relating to the employment of a person.[17]
    - Expenditure on account of an employee, which is where an employer pays for expenditure that an employee has incurred or would incur.[18]
    - "Any other benefit in money", which is intended to have broad application to include all monetary benefit derived in connection with a person's employment, no matter how they are characterised.[19]
33. TCO noted that the Taxpayer did provide services to Company B, and it had been previously concluded that the Taxpayer had not proven CCS's characterisation of the disputed payments was wrong. TCO considered the best explanation for the disputed payments was that they were the Taxpayer's return for work they performed for Company B.
34. TCO concluded that the disputed payments came within s CE 1(1) as being salary or wages, or alternatively, they were "any other benefit in money" derived by the Taxpayer in connection with their employment or service.
35. The Taxpayer further argued that had they received employment income, they would have been entitled to a tax credit for the tax already deducted and paid to the Commissioner by Company B. However, the Taxpayer had not provided any evidence that any such amounts were deducted and paid to the Commissioner. Therefore, the Taxpayer had not proven that they were entitled to tax credits for the disputed income year.

Attributed CFC income

36. CCS argued that the US LLC was a CFC and, therefore, the Taxpayer had attributed CFC income under the ITA. The Taxpayer argued that the US LLC was not a CFC for New Zealand income tax purposes.
37. Section CQ 1 provides that a person's income includes any attributed CFC income of the person. A person has attributed CFC income if the criteria in s CQ 2 are met.
38. The criteria relevant to the dispute are set out in s CQ 2(1)(a)-(f). TCO decided that all but one of the criteria had been met. This meant the Taxpayer did not have any attributable CFC income under ss CQ 1 and CQ 2. For each of the requirements, TCO concluded:
    - The US LLC was a foreign company which was a CFC during one of its accounting periods for these reasons (s CQ 2(1)(a)):
        - The US LLC was a foreign company because:
            - The particular US State legislation that governs the US LLC (the State LLC legislation) provides that a limited liability company is an entity distinct from its members. It also provides that a limited liability company has the capacity to sue and be sued in its own name and the power to do all things necessary or convenient to carry on its activities. Therefore, it was considered that the US LLC met the definition of "company" in s YA 1, being a body corporate or other entity that is distinct from its members.
            - It was not a resident in New Zealand under s YD 2 as it was not incorporated in New Zealand, and it followed that it was not liable to tax in New Zealand and not treated as a New Zealand resident under the DTA.

[17] "Salary or wages" is defined in s RD 5.

[18] "Expenditure on account of an employee" is defined in s CE 5.

[19] *Public Information Bulletin* No 136 – Part 3 (February 1986); Harris et al, *Income Tax in New Zealand* (Brookers, Wellington, 2004) at [5.2].

- The US LLC was a CFC under s EX 1(1)(b) because:
  - The Taxpayer, being a New Zealand resident, had at least a 40% control interest[20] in the US LLC. Relevantly, a person has a direct control interest in a foreign company if they held any shares in the company (s EX 5(1)(a)) or if they had a right to receive any income of the company (s EX 5(1)(c)). A share includes any interest in the capital of a company.[21] The provisions of the State LLC legislation indicate that an LLC of that State does not have shareholders but has members. Prior to dissolution, a member of an LLC has a right to receive distributions from the LLC in equal shares with other members and upon winding up, the members have a right to receive any surplus remaining after creditors have been paid. Given that the Taxpayer is the only member of the US LLC, the Taxpayer had a right to receive 100% of any distributions of capital or income from the US LLC prior to its dissolution and on winding up. It was considered that the Taxpayer's interest in the US LLC included an interest in the capital of the US LLC and, therefore, met the definition of a "share". It followed that the Taxpayer had a 100% control interest in the US LLC under s EX 5(1)(a). The Taxpayer also had a 100% control interest under s EX 5(1)(c) for the same reasons.
  - There was no evidence to suggest that anyone other than the Taxpayer held a control interest in the US LLC. Therefore, the circumstances in s EX 1(1)(1)(b)(i)-(iii) did not apply.
- The US LLC was a CFC during one of its accounting periods.[22]

- The requirement that the US LLC's accounting period ended during the income year was met (s CQ 2(1)(b)).
- The Taxpayer was not a portfolio entity (s CQ 2(1)(bb)). The Taxpayer was not a company or a fund and, therefore, could not be a portfolio investment entity.[23]
- The Taxpayer had an income interest in the US LLC for the accounting period (s CQ 2(1)(c)).[24] For the same reasons it was concluded that the Taxpayer had a 100% control interest in the US LLC under s EX 5(1), it was also concluded that the Taxpayer had 100% of the income interest in the US LLC under s EX 9(1).
- The requirement that the Taxpayer was a New Zealand resident but not a transitional resident during the accounting period was met (s CQ 2(1)(d)).
- The requirement that the Taxpayer's income interest was 10% or more and they were not a portfolio investment entity under s EX 14(1) was met (s CQ 2(1)(e)).
- The Taxpayer did not derive attributable CFC income for the accounting period under s EX 20C. Therefore, the requirement under s CQ 2(1)(f) was not met. For the Taxpayer to have derived attributable CFC income from the US LLC, all the criteria for an attributable CFC amount in s EX 20B(9)(a)-(f) must have been met.[25] Section EX 20B(9)(f) requires that a person who holds an attributing interest in the CFC files a return in which the attributed amount from the CFC is included. However, given the Taxpayer did not file such a return, that requirement was not met.

39. Even though it was decided the Taxpayer did not have attributable CFC income under ss CQ 1 and CQ 2, TCO noted that the Taxpayer may have attributed income under ss GB 27-29. As the parties did not address this issue, the dispute was referred back to the parties to allow them the opportunity to do so.

Issue 3 | Take tuatoru: New Zealand's taxing rights under the DTA

40. To determine whether New Zealand had the right to tax the disputed payments, it was necessary to consider:
    - whether the Taxpayer was a tax resident of New Zealand or the US under the tie-breaker test in article 4 of the DTA; and
    - whether article 15 of the DTA applied to treat the Taxpayer's income from Company B as taxable only in New Zealand.

[20] Control interests are defined in ss EX 2 and EX 7, which relate to direct and indirect control interests respectively. Indirect control interests were not relevant to the dispute.

[21] Definition of "share" in s YA 1.

[22] For a foreign company, the term "accounting period" means the foreign company's accounting year. Since there was no evidence of a balance date for the US LLC, it was considered that the company's accounting year was its tax year.

[23] See s HM 2.

[24] See ss EX 8 and EX 9.

[25] Section EX 20C(3)(a) provides that "attributable CFC" is the CFC's "attributable CFC amount". An attributable CFC amount is calculated using a formula that includes a "gross" amount (s EX 20B(1)). Relevantly, the item "gross" in this formula includes income for personal services of a type referred to in s EX 20B(9) (s EX 20B(3)(h)).

41. CCS argued that:
    - the Taxpayer was a New Zealand resident under the tie-breaker test;
    - article 15 of the DTA gave New Zealand the right to tax the disputed payments;
    - alternatively, if the Taxpayer was treated as a US tax resident under the tie-breaker test, CCS argued that article 15 treated the Taxpayer's income as taxable in New Zealand.
42. The Taxpayer argued that they were a US resident under the tie-breaker test. They did not advance any arguments concerning article 15.

Approach to the interpretation of double taxation treaties

43. The general approach to interpreting a double taxation treaty was considered.
44. Article 31(1) of the Vienna Convention on the Law of Treaties 1969 provides that a treaty shall be interpreted in accordance with the ordinary meaning of the terms of the treaty in their context and in light of its object and purpose.
45. The background of a treaty can legitimately be taken into account as part of the context relevant to the interpretation of its terms.[26] The courts of New Zealand and other countries refer to the OECD Model and OECD Model Commentary for background context.[27]
46. It is generally accepted that the OECD Model and Commentary, which is updated periodically, can be referred to for the purpose of interpretating a double taxation treaty, provided the amendments are intended to clarify, not change, the meaning of the relevant articles.[28]

Tie-breaker test under article 4 of the DTA

47. The parties to the dispute agreed that the Taxpayer was a tax resident of both New Zealand and the US under each country's domestic law. Consequently, the Taxpayer's tax residence for the purposes of the DTA was determined under the tie-breaker tests in article 4 of the DTA.[29]
48. The tie-breaker tests are applied in the following order until residence can be determined under one of them:
    - Permanent home available.
    - Centre of vital interests.
    - Habitual abode.
    - Citizenship.
    - Mutual agreement between the competent authorities.

Article 4 - permanent home test

49. Determining whether a home is available involves assessing factors such as whether:
    - the home is capable of being used by the person;[30]
    - the person has a right to determine occupancy and possession of the property; and
    - the person has the power to dispose of the property.
50. The parties agreed that the Taxpayer did not have a permanent home in New Zealand. CCS argued that the Taxpayer did not have a permanent home in the US either.
51. TCO considered that there was no evidence to support the Taxpayer's claim that the Taxpayer arranged and maintained accommodation in a family member's home in the US for their permanent use. It was considered the home was available as short-term accommodation while the Taxpayer was in the US. Further, the bank statements of Company B and the US LLC showed these companies paid for the Taxpayer's accommodation while they were in the US.

[26] *Anson v Commissioners for Her Majesty's Revenue and Customs* [2015] UKSC 44 at [58]; Chatfield & Co Limited v Commissioner of Inland Revenue [2015] NZHC 2099 at [53].

[27] *Commissioner of Inland Revenue v JFP Energy Inc* [1990] 3 NZLR 536 (CA).

[28] See OECD Commentary Introduction [33] and [36] at 1-10, 1-11; *R v Prévost Car Inc* 2009 FCA 57, [2010] 2 FC 65 at [10] to [11]; *Chatfield & Co.*

[29] The DTA overrides the provisions in the ITA. See s BH 1.

[30] *Case 12/2011* [2011] NZTRA 08, (2011) 25 NZTC 1-012, *Case J41* (1987) 9 NZTC 1,240.

52. TCO concluded that the Taxpayer did not have a permanent home in either New Zealand or the US. Therefore, it was necessary to consider the personal and economic relations test.

Article 4 - personal and economic relations (centre of vital interests) test

53. Article 4 of the DTA gives preference to the country to which the Taxpayer's personal and economic relations (centre of vital interests) are closer. The Taxpayer's personal and economic relations with both countries must be considered.

54. The following are some key principles in applying the centre of vital interests test:

- Factors taken into account include the person's family and social relations, occupations, political, cultural or other activities, place of business, and place from which property is administered. The circumstances must be examined as a whole, but considerations based on the personal acts of the individual must be given special attention.[31]
- The depth of the roots of one's centre of vital interests is more important than the number of connections on each side.[32]
- If the economic factor is closer to one place and the personal factor closer to another, it will be resolved by which of the two localities is of greater significance to the taxpayer.[33]
- Commentators have suggested in the context of the permanent place of abode test in s YD 1(2) that where a person does not have a spouse or children, and no longer lives with their parents, the relevance of family ties is less important.[34] It was considered that the same logic is equally applicable in the context of the closer personal and economic relations test.

55. In relation to the Taxpayer's economic ties, TCO considered that:

- While the Taxpayer had business connections with both countries, the New Zealand connections were closer than the US connections.
- Significantly, all of Company B and the US LLC's business income was sourced from New Zealand and the activities that produced the income were carried on in New Zealand.
- The administration of the Taxpayer's properties, which included shares in various New Zealand companies, membership interest in the US LLC, and bank accounts used for private purposes, was more closely associated with New Zealand than the US in the disputed income year.
- The fact that the Taxpayer had spent significantly more time in New Zealand than in the US indicated the Taxpayer had more opportunity to carry out administrative activities in New Zealand.

56. As to the Taxpayer's personal relations, TCO considered that:

- The Taxpayer had family and social relations with the US. Even though the Taxpayer had spent more time in New Zealand than in the US and could stay with friends and clients rent free, this circumstance is outweighed by the Taxpayer's US origins, their strong family connections with the US and the fact they do not have family in New Zealand.
- There was no evidence of any political, cultural or other activities undertaken in either of the countries during the disputed income year.

57. In weighing up all the relevant considerations, TCO concluded that the strength of the Taxpayer's economic relations to New Zealand tipped the balance in favour of New Zealand. It was noted that as the Taxpayer did not have a spouse or children and no longer lived with their parents, the relevance of family ties is less important.

58. Accordingly, it was decided that the Taxpayer's centre of vital interests was in New Zealand. This meant that the Taxpayer was treated as a New Zealand resident for the purposes of the DTA.

Article 4 – habitual abode test

59. For completeness, TCO considered the habitual abode test briefly, in case it was subsequently found that the Taxpayer's centre of vital interests could not be determined.

[31] The OECD commentary on article 4 of the OECD Model Convention at [15].

[32] *Hertel v MNR* 93 DTC 721 at 723.

[33] *Case 12/2011* at [62].

[34] See Craig Elliffe, *International and Cross-Border Taxation in New Zealand* (2nd ed, Thomas Reuters, Wellington, 2018) at 7.2(d), citing *Case U17* (1999) 19 NZTC 9,174 in support.

60. The following principles apply to the habitual abode test:
    - The concept of habitual abode involves notions of frequency, duration and regularity of stays of a quality that is more than transient. A person will have a habitual abode in a country if they live there habitually or normally. A person may habitually live in more than one country.[35]
    - In assessing whether a stay is more than transient, the reasons for the stay are relevant.
    - The test is applied by taking into account all of a person's stays in a country, not only those at a home the person owns or rents there.[36]
    - The test is not applied by focusing only on the income year concerned but must cover a sufficient length of time.
61. TCO considered that the amount of time the Taxpayer spent in New Zealand, the pattern of residing here over an extended period of time, and the reasons for coming to New Zealand all support a conclusion that the Taxpayer had a habitual abode in New Zealand in the disputed income year. The frequency, duration and regularity of the Taxpayer's stays were more than transient. This was contrasted with the relatively short periods of time that the Taxpayer spent in the US.

Article 4 tie-breaker test – conclusion

62. It was concluded that the Taxpayer was a New Zealand resident under the tie-break test in article 4 for these reasons:
    - The Taxpayer did not have a permanent home available in New Zealand or in the US.
    - The Taxpayer's personal and economic relations with New Zealand were closer than they were with the US.
    - If it was necessary to do so, it would also be concluded that the Taxpayer had a habitual abode in New Zealand and not in the US.

Article 15 (dependent personal services) of the DTA

63. Article 15(1) would give New Zealand the exclusive right to tax the disputed payments if the following criteria were met:
    - the Taxpayer was a New Zealand resident under the DTA;
    - the income was salary or wages or other similar remuneration from employment; and
    - the income was not derived from services performed in the US.
64. As had previously been concluded, the Taxpayer was a New Zealand resident for the purposes of the DTA; the Taxpayer's income from Company B had the character of salary and wages from employment; and the income was derived from personal services performed by the Taxpayer in New Zealand. It followed that the disputed payments derived by the Taxpayer from Company B were only taxable in New Zealand.
65. However, in case it was found that the Taxpayer performed services from both New Zealand and the US, TCO also considered the application of the proviso in article 15(2). Article 15(2) provides that remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if all three requirements in article 15(2)(a)-(c) are met.
66. For the current dispute, if the Taxpayer derived income from services performed in the US, the Taxpayer's income would be taxable only in New Zealand if all these requirements were met:
    - the Taxpayer was present in the US for no more than 183 days in any consecutive 12 month period;
    - the Taxpayer's remuneration was paid by an employer who was not a US resident; and
    - the remuneration was not borne by a permanent establishment which the Taxpayer's employer had in the US.
67. The Taxpayer was only present in the US for 16 days during the disputed income year; Company B was not a US resident; and Company B did not have a permanent establishment in the US. Consequently, it was decided that all the disputed payments were only taxable in New Zealand, even if the Taxpayer performed some services in the US.
68. Further, TCO agreed with CCS's alternative argument that if it were found that the Taxpayer was a US resident under the DTA, article 15(1) would give New Zealand the right to tax the Taxpayer's income because the income was derived from an employment exercised in New Zealand. However, this is subject to the proviso in article 15(2). The effect of the proviso is that the Taxpayer's income would be taxable only in the US if the following requirements were met:

[35] *Lingle v R* 2010 FCA 152.

[36] OECD commentary on article 4 of the OECD Model Convention.

- the Taxpayer was present in New Zealand for no more than 183 days in any 12 month period; and
- the payer of the Taxpayer's remuneration (i.e. Company B) was not a resident of New Zealand; and
- the Taxpayer's remuneration was not borne by a permanent establishment that the Taxpayer's employer (Company B) had in New Zealand.

69. CCS conceded that the first of these requirements was met but argued the second two were not. The Taxpayer did not dispute CCS's position, and no evidence was provided to support a conclusion the second two requirements would be met. Consequently, if it was found that the Taxpayer was a resident of the US, their income would still be taxable in New Zealand.

New Zealand's tax rights under the DTA – overall conclusion

70. It was concluded that New Zealand was allocated taxing rights under the DTA. If, and to the extent that, the Taxpayer was liable to tax in both New Zealand and the US on the same income, article 22 of the DTA may require the US to provide a tax credit for tax paid in New Zealand.

Issue 4 | Take tuawhā: Shortfall penalties

71. In Issue 4, all legislative references are to the TAA unless stated otherwise.

72. CCS argued that the Taxpayer was liable under s 141C to pay a gross carelessness shortfall penalty in relation to the tax shortfalls that occurred in the disputed income year. Alternatively, if the Taxpayer was not liable for a gross carelessness shortfall penalty, they were liable for a shortfall penalty for not taking reasonable care under s 141A. In either case, CCS considered that the Taxpayer was not entitled to a penalty reduction under s 141FB because the Taxpayer was liable for a disqualifying penalty within the applicable qualifying period.

73. The Taxpayer argued that they were not liable to pay any shortfall penalties because they had correctly filed a return and declared their income in the US, as required by the provisions of the DTA.

Shortfall penalty for gross carelessness

74. Section 141C imposes a shortfall penalty for gross carelessness on a taxpayer if the following requirements are satisfied:[37]

- The taxpayer has taken a tax position.
- Taking the tax position has resulted in a tax shortfall.
- The taxpayer has been grossly careless in taking the taxpayer's tax position. Gross carelessness means doing or not doing something in a way that, in all of the circumstances, suggests or implies a complete or high level of disregard for the consequences (s 141C(3)):
  - Gross carelessness is characterised by conduct which creates a high risk of a tax shortfall occurring where that risk and its consequences would have been foreseen by a reasonable person in the circumstances.[38]
  - The test for gross carelessness is not whether the taxpayer actually foresaw the probability that their act or omission would cause a tax shortfall but whether a reasonable person would have foreseen that probability.[39] Whether the taxpayer has acted intentionally is not a consideration.[40]
  - Gross carelessness is similar to recklessness, which covers a range of states of mind from failing to give any thought to whether there is a risk to recognising the existence of a risk and deciding to ignore it.[41]
  - A person who takes reasonable care is not grossly careless. Taking reasonable care includes exercising reasonable diligence to determine the correctness of a return, keeping adequate records, and generally making a reasonable attempt to comply with tax law.[42]
  - A taxpayer who adequately informs and follows the advice of a qualified tax agent takes reasonable care and is not careless.[43]

[37] The shortfall penalty for gross carelessness is considered in the Interpretation Statement: *Shortfall Penalty for Gross Carelessness* as published in *Tax Information Bulletin* Vol 16, No 8 (September 2004).

[38] *Case W4* (2003) 21 NZTC 11,034 at [44].

[39] *Case 9/2014* (2014) 26 NZTC 2,019 at [88].

[40] *Case W4* at [60].

[41] *Case W4* at [48]; *R v Caldwell* [1982] AC 341 (HL); *R v Howe* [1982] 1 NZLR 618 (CA).

[42] *Case W4* at [60].

[43] *Re Carlaw and FCT* 95 ATC 2166 (AAT); *Re Sparks and FCT* [2000] AATA 28 and see also *Pech v Tilgals* [1994] ATC 4206.

75. The following factors may be relevant in determining whether a reasonable person would have foreseen that their conduct created a high risk of a tax shortfall occurring:[44]
    - the significance of the transaction leading to the tax shortfall;
    - the taxpayer's level of experience in the relevant tax laws;
    - previous warnings given by Inland Revenue or advisors in relation to the risk of the tax shortfall.
76. The penalty payable for gross carelessness is 40% of the resulting tax shortfall.
77. However, under s 141C(4) a taxpayer who takes an acceptable tax position is not grossly careless in taking their tax position. A tax position is an acceptable tax position if it is "about as likely as not to be correct". This is determined objectively.[45]
78. A tax position will be "about as likely as not to be correct" and, therefore, an acceptable tax position, if:
    - The tax position is close to or around 50% likely to be correct.[46]
    - The merits of the arguments supporting the tax position are substantial.[47]
    - On balance, the tax position is one that, while wrong, could be argued on rational grounds to be right.[48]
    - There is room for a real and rational difference of opinion.[49]
    - The taxpayer's tax position is one about which "reasonable minds could differ".[50]
79. TCO considered that the Taxpayer was liable to pay a shortfall penalty for gross carelessness under s 141C because:
    - The Taxpayer did not take adequate steps to determine if they had assessable income. There was no evidence of the Taxpayer seeking professional advice on the application of the DTA, which involved a degree of complexity. This conduct created a high risk of a shortfall occurring.
    - The law regarding income under ordinary concepts and employment income and the application to the Taxpayer's situation was relatively straightforward. Further, the law on record keeping requirements that apply to taxpayers was also straightforward and easy to understand.[51]
    - The Taxpayer's background indicated that they had a reasonably high level of commercial and financial awareness. A reasonable person in the Taxpayer's circumstances would have foreseen the risk of a tax shortfall.
    - The Taxpayer had been the subject of previous audits in which they were found to have omitted income from their tax returns and became liable to pay a shortfall penalty. They were also involved in the audit of Company B in which it was found that the company had claimed deductions that it was not entitled to.
    - It followed that in taking their tax position, the Taxpayer acted in a way that in all of the circumstances suggests or implies a complete or high level of disregard for the consequences.

Shortfall penalty for not taking reasonable care

80. Section 141A imposes a shortfall penalty on a taxpayer for not taking reasonable care if the following requirements are satisfied:[52]
    - The taxpayer has taken a tax position.
    - The taxpayer's tax position has led to a tax shortfall.
    - The taxpayer has not taken reasonable care in taking the taxpayer's tax position.

[44] *Case W4*.

[45] See definition of "acceptable tax position" and "unacceptable tax position" in s 3(1) and s 141B.

[46] *Case U47* (2000) 19 NZTC 9,410.

[47] *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115.

[48] *Ben Nevis* and *Walstern v FCT* [2003] FCA 1,428.

[49] *Walstern*.

[50] *Walstern* and *Case X25* (2006) 22 NZTC 12,303.

[51] The record keeping requirements are contained in ss 15B and 22 of the TAA.

[52] The shortfall penalty for not taking reasonable care is considered in Interpretation Statement: *Shortfall penalty for not taking reasonable care* published in *Tax Information Bulletin* Vol 17, No 9 (November 2005).

81. A taxpayer will be treated as having taken reasonable care in these two situations:
    - If the taxpayer has relied on the action or advice of a tax advisor engaged by the taxpayer.[53]
    - If the taxpayer has taken an acceptable tax position.[54]
82. Case law has also developed the following principles about "reasonable care":
    - The test of "reasonable care" is whether a reasonable person in the taxpayer's circumstances would have foreseen a tax shortfall as a reasonable probability.[55]
    - Reasonable care includes exercising reasonable diligence to determine the correctness of a return, keeping adequate records to properly substantiate a return and generally making a reasonable attempt to comply with tax law.[56]
    - What is considered "reasonable" may vary depending on a number of factors, including:[57]
        - the experience of the taxpayer;
        - the type of tax involved;
        - the size and nature of the business;
        - the complexity of the law;
        - the particular transaction;
        - the difficulty and expense of taking appropriate precautions.
83. A taxpayer is vicariously responsible for any tax position taken by its officers or employees.
84. The penalty payable for not taking reasonable care is 20% of the tax shortfall.
85. TCO concluded that the Taxpayer was liable for a shortfall penalty for not taking reasonable care under s 141A. The matters that established the Taxpayer was liable for a gross carelessness shortfall penalty also established that a reasonable person in the Taxpayer's circumstances would have foreseen the tax shortfall as a reasonable probability. The requirements for this shortfall penalty were, therefore, satisfied.

Reduction for previous behaviour

86. Under section 141FB(2), a shortfall penalty (the current penalty) can be reduced by 50% if a taxpayer is not liable for another shortfall penalty that is a disqualifying penalty. A disqualifying penalty is defined in s 141FB(3)(b).
87. Given the shortfall penalties that were imposed in a previous dispute came within the definition of "disqualifying penalty", the Taxpayer did not qualify for the 50% reduction of the current penalty.

Shortfall penalties – conclusion

88. A taxpayer is liable to only one shortfall penalty for each tax shortfall. Where the requirements of more than one shortfall penalty are met, the higher shortfall penalty is imposed (s149(3)).
89. Therefore, the gross carelessness shortfall penalty was applied to the Taxpayer.

[53] Section 141A(2B).
[54] Section 141A(3).
[55] *Case W4* at [59].
[56] *Case W4* at [60]-[61].
[57] *Case W3* (2003) 21 NZTC 11,014.

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

Legal Services

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

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