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TAX INFORMATION Bulletin

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Inland Revenue
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YOUR OPPORTUNITY TO COMMENT

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

You can find a list of the items we are currently inviting submissions on as well as a list of expired items at **taxtechnical.ird.govt.nz** (search keywords: public consultation).

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

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

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

Your opportunity to comment

Ref	Draft type	Title	Comment deadline
PUB00360	Question we've been asked	Deductibility of overseas expenses	8 August 2022
PUB00415	Question we've been asked	Can a close company deduct interest on a shareholder advance where the amount is not known until after balance date?	9 August 2022
PUB00394	Issues paper	Income Tax – Government payments to businesses (grants and subsidies)	11 August 2022
PUB00424	Public rulings	Goods and Services Tax – Directors' fees	17 August 2022

IN SUMMARY

New legislation

The Taxation (Cost of Living Payments) Bill was passed under urgency on 19 May 2022. The new Act received Royal assent on 24 May 2022.

The new legislation allows the Commissioner of Inland Revenue to make payments to eligible individuals under the Cost of Living Payments Scheme and to administer the scheme on behalf of the Government.

The new Act amends the Tax Administration Act 1994 and the Income Tax Act 2007.

Determinations

This variation provides extra time to file the statements required by section 70C of the Tax Administration Act 1994, in relation to R&D loss tax credits, when the statements were unable to be filed on time due to COVID-19 response measures or as a consequence of COVID-19.

This variation provides extra time to file for a person with a June balance date who is seeking the Commissioner's approval of their research and development activities by filing a general approval application for the 2021-2022 income year under s 68CB of the Tax Administration Act 1994.

Operational statement

This statement prescribes the manner by which a tax agent or a representative can obtain the authority to act from their clients.

Interpretation statement

This interpretation statement considers whether the land sale rules in the Income Tax Act 2007 apply to changes to co-ownership of land and changes of trustees of a trust.

Question we've been asked

This question we've been asked discusses the GST treatment of garbage disposal, lighting and security, aircraft parking and terminal services that airport operators supply to international airline operators.

IN SUMMARY (continued)

Technical decision summaries

NEW LEGISLATION

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

Taxation (Cost of Living Payments) Act 2022

The new legislation allows the Commissioner of Inland Revenue to make payments to eligible individuals under the Cost of Living Payments Scheme and to administer the scheme on behalf of the Government.

Overview

The Taxation (Cost of Living Payments) Bill was passed under urgency on 19 May 2022. The new Act received Royal assent on 24 May 2022. It amends the Tax Administration Act 1994 and the Income Tax Act 2007.

The new legislation allows the Commissioner of Inland Revenue to administer the Cost of Living Payments Scheme.

Cost of Living Payments Scheme

Sections 3, 7AAA, and 157 of the Tax Administration Act 1994; sections CW 33 and MB 13 of the Income Tax Act 2007

The Act provides authorisation for the Commissioner of Inland Revenue to administer the Cost of Living Payments Scheme (the scheme) on behalf of the Government and make payments to eligible individuals.

Background

The Act contains several amendments to enable the scheme to provide temporary financial support to eligible low-to middle-income individuals facing increased cost-of-living pressures because of the recent spike in inflation. The scheme will be administered by Inland Revenue.

Under the scheme, cost of living payments totalling $350, which is half the couple rate for the winter energy payment (WEP), will provide short-term support for low-to middle-income individuals earning $70,000 or less in the 2021–22 tax year and who are not eligible for the WEP.

The payments will be made in three monthly instalments from 1 August 2022 and will be made at a flat rate with no apportionment. Eligibility will be assessed for each instalment separately.

More detailed information on the operation of the scheme is available on Inland Revenue's website at:
ird.govt.nz/cost-of-living-payment

Key features

The new Act makes the following changes to the Tax Administration Act 1994 (TAA):

- Inserting the definition of the 'Cost of Living Payments Scheme' in section 3 of the TAA for the purpose of administering the scheme.
- Amending the definition of 'disputable decision' in section 3 of the TAA to exclude a decision to make, or to decline to make, a payment under the scheme.
- Amending the definition of 'tax' in section 3 of the TAA to allow Inland Revenue to use its existing debt recovery and care and management powers to administer the scheme.
- Inserting new section 7AAA to the TAA to enable the Commissioner of Inland Revenue (the Commissioner) to administer the scheme.
- Amending section 157 of the TAA to include payments made under the scheme.

The new Act makes the following changes to the Income Tax Act 2007:

- Amending section CW 33 to exempt a payment made under the scheme from income tax.
- Amending section MB 13 to exclude a payment under the scheme from family scheme income.

Effective date

The amendments applied from the day after the date the Act received Royal assent - 25 May 2022.

Detailed analysis

The Act amends the Tax Administration Act 1994 and the Income Tax Act 2007.

Section 3 of the Tax Administration Act 1994

Definition of 'cost of living payments scheme'

The definition of the Cost of Living Payments Scheme is inserted in section 3 of the Tax Administration Act 1994 for the purpose of administering the scheme.

The definition of the 'cost of living payments scheme' means the Cost of Living Payments Scheme established and administered by the Crown to provide financial support to certain low- and middle-income persons affected by an increase in the cost of living.

Definition of 'disputable decision'

The definition of 'disputable decision' in section 3 of the Tax Administration Act 1994 is amended to exclude a decision to make, or to decline to make, a grant under the Scheme.

Definition of 'tax'

The definition of 'tax' in section 3 of the Tax Administration Act 1994 is amended to include an amount payable in relation to the grant made under the scheme. The amendment would allow Inland Revenue to use its existing debt management and care and management powers to administer the grant. These are:

- Care and management powers (sections 6 to 6B): this would allow the Commissioner to use their existing care and management powers when making resourcing decisions.
- Recovery powers (sections 156 to 165): this includes the existing recovery powers available to the Commissioner under the TAA.
- Relief provisions (sections 174AA, and 176 to 177CA): this includes write-off of small amounts, general recovery powers and the hardship provisions (such as not to recover if it would be an inefficient use of resources).

Section 157 of the Tax Administration Act 1994

The definition of 'income tax' in section 157(10) of the Tax Administration Act 1994 is amended to include the entire amount of the grant. This means that if a recipient makes a default in the repayment of the grant to the Commissioner, the Commissioner may pursue the outstanding balance by issuing a notice under section 157.

Section 7AAA of the Tax Administration Act 1994

New section 7AAA includes the administration of the Cost of Living Payments Scheme as a function of the Commissioner. This allows Inland Revenue to use the information it already holds to determine eligibility and to make payments.

This section also includes a requirement for the eligibility criteria for the payment to be published on a website administered by the Commissioner. This requirement ensures that the criteria that the Government has set are publicly available, as they are not included in primary legislation. If a person receives a grant and does not qualify under the eligibility requirements, the grant is repayable. The main eligibility criteria are discussed below and are published on Inland Revenue's website at: **ird.govt.nz/cost-of-living-payment**

Section CW 33 of the Income Tax Act 2007

The amendment to section CW 33 of the Income Tax Act 2007 exempts a payment under the scheme from income tax. This means a payment under the scheme will not be:

- subject to income tax
- offset against other amounts owed to Inland Revenue, or
- included as income for social policy purposes (for example, child support, student loan or for Working for Families tax credit purposes).

Section MB 13 of the Income Tax Act 2007

The amendment to section MB 13 of the Income Tax Act 2007 excludes a payment under the scheme from the calculation of a person's family scheme income. This ensures that the payment will not inadvertently be included in the catch-all provision (MB 13) which includes income from other payments.

Eligibility Criteria

The eligibility criteria for the Cost of Living Payment are published on Inland Revenue's main website at **ird.govt.nz/cost-of-living-payment**

The main eligibility criteria for receiving the payments are:

- net income of $70,000 or less in the period 1 April 2021 to 31 March 2022
- a finalised income tax assessment for the period 1 April 2021 to 31 March 2022 (excluding those individuals with PIE only income or those with no income from any source who file or request an unnecessary return)
- not receiving a qualifying benefit for the WEP (Sole Parent Support, Supported Living Payment, Jobseeker Support, Jobseeker Support Student Hardship, Emergency Benefit, Emergency Maintenance Allowance, Youth Payment, Young Parent Payment, New Zealand Superannuation, or Veteran's Pension) on the date eligibility is assessed
- aged 18 or over
- both New Zealand tax resident and present in New Zealand, and
- not in prison.

The payment is not intended to go to people who have died.

LEGISLATION AND DETERMINATIONS

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

COV 22/18: Variation in relation to s 70C of the Tax Administration Act 1994 to extend deadline for filing statements in relation to R&D loss tax credits

Variation

For a statement in relation to R&D loss tax credits and R&D repayment tax for the 2021 tax year under s 70C of the Tax Administration Act 1994, the date by which that statement must be filed is extended to include a statement filed with the Commissioner on or before 31 August 2022.

This is subject to the conditions that:

- This variation only applies to a person that has had difficulty filing the statements on time because of circumstances arising either from the imposition of COVID-19 response measures or because of COVID-19. This could include the impact of a key staff member or advisor having reduced availability, or the financial impact of COVID-19 causing significant disruption to the normal business operations of the person.
- This variation also applies when a person has filed their statement late in reliance on the Commissioner's advice that, due to the likely impact of Covid-19, no penalties will apply to the late filing of income tax returns that are furnished by 31 May 2022, including a failure to meet that extended date due to Covid-19.

Application date

This variation applies from 1 April 2022 to 31 August 2022.

Dated at Wellington on 23 June 2022.

Jonathan Rodgers
Group Leader – Tax Counsel Office
Inland Revenue

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

Summary of effect

1. Section 70C of the TAA requires a person to file a statement in relation to R&D loss tax credits or R&D repayment tax no later than the earliest of the day on which they file a return of income for the relevant tax year, or the last day for filing a return of income for the tax year under s 37. For the 2021 tax year, the time within which a statement must be filed has been extended to 31 August 2022 using s 6I of the TAA.

Provisions affected

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

Application of variation

3. This variation applies to a person who wishes to file a statement in relation to R&D loss tax credits and R&D repayment tax for the 2021 tax year. The variation recognises that the impact of COVID-19 means that some taxpayers who would otherwise have filed a statement on time have been unable to do so. The variation is subject to the application of the conditions specified above.

References

Legislative references

Tax Administration Act 1994: ss 6H and 6I

Tax Administration Act 1994: s 70C

COV 22/19: Variation to section 68CB(2) of the Tax Administration Act 1994

Variation

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

> For a general approval application in relation to the R&D tax credit for the 2021-2022 income tax year under section 68CB(2) of the Tax Administration Act 1994, for applicants whose 2021-2022 income year ends on 30 June 2022, the date on or before which that application must be filed with the Commissioner is amended to be 30 September 2022.
>
> This variation only applies in circumstances where the planning or conduct of eligible research and development or the ability to appropriately obtain necessary information, seek advice and formulate an application under section 68CB of the Tax Administration Act 1994 on time has been materially delayed or disrupted because of circumstances arising either from COVID-19 or COVID-19 response measures. This could include the impact of a key staff member or advisor having reduced availability, or the financial impact of COVID-19 causing significant disruption to the normal business operations of the taxpayer.

Application date

This variation applies from 6 July 2022 to 30 September 2022.

Dated at Wellington on 6 July 2022.

Jonathan Rodgers
Group Leader – Tax Counsel Office
Inland Revenue

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

Summary of effect

1. The effect of the variation will be to extend from 7 August 2022 to 30 September 2022 the time by which a person with a 30 June balance date, to be entitled to research and development tax credits under s LY 1 of the Income Tax Act 2007, must apply for a general approval for the 2021-2022 income year.

Provisions affected

2. Section 68CB(2) of the Tax Administration Act 1994.

Application of variation

3. This variation applies to a person who is seeking the Commissioner's approval of their research and development activities by filing a general approval application for the 2021-2022 income year under s 68CB of the Tax Administration Act 1994.
4. The variation recognises that the impact of COVID-19 means the planning or conduct of research and development or the ability to obtain information, seek advice and formulate an application or complete a return, for some customers has been materially delayed.

References

Legislative references

Tax Administration Act 1994: ss 6H and 6I, s 68CB(2)

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 22/03: Authority to Act for Tax Agents and other Intermediaries and Nominated Persons

All legislative references in this Statement are to the Tax Administration Act 1994 (TAA), unless specified otherwise.

Introduction

This Statement prescribes the manner by which a tax agent or a representative can obtain the authority to act from their clients.

Schedule 7, part B, clause 15 of the Tax Administration Act 1994 (TAA) allows the Commissioner to make available sensitive revenue information to the agent of a taxpayer, where that taxpayer has authorised the agent in a manner as the Commissioner prescribes.

A third-party provider, such as a tax agent or a representative, who obtains the authority to act from a client in accordance with this Statement is considered an agent of that client under Schedule 7, part B, clause 15.

As an agent, the tax agent or representative must hold authority from their client in order to link to the client's accounts and to give the agent or the agency the legal permission to deal with Inland Revenue on their client's behalf. The authority to act can either be in a written form or in electronic form.

Linking to a client means the agent will be granted direct online access to their client's tax accounts for which they have authority to act, where they will have the ability to view and update a client's records and information. It is, therefore, important for Inland Revenue to ensure that a tax agent or representative has obtained proper authorisation for that access.

This Statement sets out information about:

- who may give an authority to act;
- what the authority to act should cover;
- the requirements for obtaining authority to act electronically;
- the requirement to keep a record of the client's authority and identity verification documents; and
- Inland Revenue's process for auditing these documents.

Application of the statement

1. This Statement applies from 6 July 2022.
2. The guidelines apply to:
   - third-party providers who are listed as a tax agent under s 124C; and
   - persons who have been approved as a representative under s 124D; and
   - persons nominated to act on behalf of another in relation to the first person's tax affairs or social policy entitlements and obligation under s 124F.

   These people will collectively be referred to as "**intermediaries**" or **"nominated persons"** in these guidelines.
3. New clients and any existing clients of an intermediary requiring a new authority to act on or after the application date should follow the requirements in these guidelines.
4. These Operational Guidelines replace the IR1059: *Authority to Act guidelines for intermediaries*, as well as Pages 2-3 of the IR1025: *Correspondence guidelines* and finally, the 'Process for tax agents to obtain electronic authorities to act', published in *Tax Information Bulletin* Vol 23 No 9 November 2011.

Discussion

Who can give Authority to Act

Individuals

5. An authority to act must be obtained from the person to whom the information belongs.
6. An authority to act for an individual does not extend to that person's related entities, for example a company of which the client is a shareholder/director. If an intermediary is acting for their client's personal tax affairs as well as the affairs of their related entities and obtaining authorities to act at the same time, they may use a single authority to act for all entities. All of the entities and their respective IRD numbers that the authority is intended to apply to must be clearly listed in the authority to act. If it is not clearly listed, then separate authorities to act will be required for each entity.

Non-individuals

7. An authority to act for a non-individual must be provided by a person or persons with the requisite authority to bind that non-individual.
    - **Companies:** A person or persons who hold(s) the authority to bind the company to an agreement must provide the authority to act. This would normally be a director or a manager.
    - **Ordinary partnerships:** The authority to act must be signed by a partner or by a person who has the delegated authority to bind the partnership.
    - **Limited partnerships:** The authority to act must be signed by a general partner or a person who has the delegated authority to bind the limited partnership.
    - **Trusts:** The authority to act must be signed by all trustees, or by the trustee or trustees who have been authorised by the other trustees to act on all of their behalf.
    - **All other entities:** A person or persons with the requisite authority must sign the authority to act.
8. The rules governing the particular entity will determine how many persons need to sign the authority to act. For example, if one person holds the delegated authority to sign on behalf of the other members of the non-individual then only that person needs to sign. The person signing the authority to act must ensure that they are authorised by the non-individual to appoint the intermediary.
9. Where there has been a change to the ownership of a non-individual entity such that the person who provided the original authority can no longer bind that entity a new authority to act should be provided. (**Note:** Where there has been no change in ownership, a new authority to act would not be necessary merely because the person who signed an authority leaves that entity.)

Children under 16

10. Children under the age of 16 need a parent or guardian to complete the authority to act on their behalf. When a child of an existing client turns 16 and they become a client, the child will need to complete their own authority to act.

Incapacitated persons

11. Incapacitated or cognitively impaired customers, including children, receiving income, often from ACC to employ carers, will have tax obligations. These obligations can be met by a parent or guardian who has been given the appropriate authority to act.
12. However, if that nominated person subsequently dies or is otherwise incapacitated the process for providing an alternative authorised person with the necessary authority to act may not always be straight-forward. This is because the incapacitated customer may lack the legal capacity to nominate another person under s 124F.
13. Often the death or incapacity of an authorised parent or guardian will result in an "automatically" appointed guardian for the incapacitated customer with whom IR can liaise with regarding the customer's tax affairs (or who may affirm the continuing role of a nominated agent). However, in limited circumstances this will not occur.
14. In those limited circumstances the court will appoint a guardian (or take guardianship itself). Thereafter the IR should address itself to whomever the court has appointed (who may affirm the continuing role of a nominated person).
15. To the extent there is a period between the death or incapacity of a sole guardian and the appointment of another guardian for a child, during that period the IR should liaise with the person taking responsibility for the day-to-day care of the child. This would not breach the confidentiality obligations on IR.

16. There may be a gap between the death or incapacity of a parent or guardian and the appointment of a new guardian. For example, where:
    - there is a sole parent or guardian who dies without naming a testamentary guardian; or[1]
    - where the parent/guardian is incapacitated to such an extent they can no longer fulfil their obligations, but the testamentary guardian does not take the role.[2]
17. In such situations the court will appoint a guardian or become the guardian itself (most likely using an agent of the court). However, this does not happen automatically without the intervention of the court and the process may take some time. In the meantime, the customer will continue to have tax obligations to meet.
18. Upon getting an application for guardianship the court may make an order for an interim agent of the court to act on its behalf in guardianship matters in order that the court can then consider a more permanent solution. That person or agency will be a *de facto* guardian until guardianship can be legally resolved. For IR this means that there is a person to deal with in respect of the incapacitated person's tax affairs.
19. This means that in the limited circumstances:
    - where a sole guardian dies or is incapacitated; **and**
    - there is no 'replacement guardian' (appointed as testamentary guardian or under an enduring power of attorney); **and**
    - the Court has not yet appointed a guardian or an agent of the Court (where the court itself is the guardian); then
    - Inland Revenue will adopt a pragmatic approach and deal with the person who is fulfilling the duties of a *de facto* guardian and parent.
20. In the above circumstances, Inland Revenue is prepared to recognise the practical realities of the circumstances and recognise that the person is acting with apparent authority in a situation where no other person has actual authority. This will mean getting that person to deal with the tax issues or to appoint or affirm a nominated person Inland Revenue can deal with. Because Inland Revenue is liaising with the *de facto* guardian to carry into effect the revenue law, this would be a permitted disclosure of sensitive revenue information under s 18D.

Deceased persons

21. If a client passes away, the intermediary must obtain a new authority to act from an authorised person for the estate, such as the administrator or executor.

Deceased intermediary

22. If an intermediary who holds an authority to act on behalf of a client, passes away, that authority to act will end with the intermediary's death if the authority is given to a specified intermediary. On the other hand, where the authority to act is given to an intermediary's business or partnership, which will continue after the death of one of the intermediaries, it is likely that the existing authority to act will continue.

Verifying the identity of the person giving authority

23. The identity of the person providing the authority to act must be established to a high degree of confidence to ensure that they are entitled to provide that authority. That is, the intermediary must be satisfied that the information they are authorised to access belongs to that person or that the person can authorise access of information on behalf of a non-individual (for example a director/shareholder of a company).
24. It may sometimes, depending on the circumstances, be prudent for an intermediary to check that they have been properly appointed. An intermediary may wish to verify a signatory's authority as part of the identity verification process, for example, by obtaining and holding a copy of the trustee resolution that gives authority to a particular trustee to act on behalf of the other trustees.

Information needed on the authority to act

25. For Inland Revenue to be satisfied that sufficient authority to act has been obtained, the following must be clearly addressed in the authority:
    - The client's full name and IRD number.

[1] Or where both parents/guardians die at the same time or in close proximity.

[2] It is assumed the guardian has not prepared an enduring power of attorney dealing with the guardianship.

- The authority to act must be dated and signed by the client.
- Where the client is a non-individual entity, the name and the position of each signatory in the non-individual entity must be clearly stated.
- The full name of the intermediary.
- Where the intermediary is in the name of an individual, the authority should also include the words "and staff or contractors", as applicable.
- The tax accounts the intermediary will be acting on behalf of the client for or state "ALL" if the client gives authority to act for ALL tax accounts. (Note: a tax account can include student loan and social policy entitlements, however an intermediary cannot link to Child Support, Paid Parental Leave or KiwiSaver accounts).
- Authorise the intermediary to obtain the client's information from Inland Revenue through all channels, including Inland Revenue's online services.

26. If applicable, the authority to act should also:
    - Authorise the intermediary to sign tax returns on behalf of the client.
    - Specify the time for which the authority to act endures. If no timeframe is specified, then the authority will apply until it is terminated.
    - Specify how and when the authority to act can be terminated by either party.
    - State that authority is given for any refunds and other credits to be released to the intermediary's trust account.
    - Authorise the intermediary to adjust, correct and finalise the client's pre-populated or final account.
    - State whether the intermediary or the client is responsible for checking the correctness of the pre-populated or final account.
27. The authority to act must also make clear that if a client has been delinked or the nature of an existing authority changes for any reason, a new authority to act needs to be obtained before the intermediary can re-link and access the client's information.
28. Examples of circumstances a new authority to act is required for existing clients are:
    - The client requires the intermediary to act for a tax type that was not originally authorised for.
    - Client engages the services of another intermediary and unknowingly ceases the old intermediary's authority.
29. An intermediary may also want to ensure that a client understands that linking to a tax account will allow the intermediary to have full access to the information held by Inland Revenue, and may have the ability to modify client details, relating to the tax accounts they are linked to.
30. Please note: A client's agreement to the intermediary's terms and conditions or contract may not necessarily mean the client has given authority to act for Inland Revenue's purposes. The authority to act clauses must be explicit in the agreement or agreed to separately.

Group of taxpayers

31. Where a group of related taxpayers are onboarded at the same time, Inland Revenue will accept one authority to act document for all of the related taxpayers, **only** if the following additional requirements are complied with:
    - The name and IRD number of the individual and/or entities are clearly listed in the authority to act document.
    - The authority to act is signed by all applicable individuals and persons with the requisite authority to bind the non-individual entities.
    - The positions of the signatories in the non-individual entities must be clearly stated.
32. Any new related entities or individuals that the intermediary will act for in the future will require a new authority to act and cannot be retrospectively added to an existing authority.

Onboarding clients electronically

33. With many businesses conducting more of their services online, an intermediary may choose to onboard clients electronically, without meeting a client face to face.
34. The information requirements for an authority to act in [25]-[32] may be met electronically, such as using an online electronic platform, provided that all required information is clearly set out in the electronic authority to act and that the authority to act is readily accessible for review when requested by Inland Revenue.

35. It is important that new clients are aware and understand what they are authorising the intermediary to do. To that end, an intermediary may choose to adopt a "tick box" approach to ensure that the clauses of the authorisation are read and explicitly agreed to.
36. Where this approach is used, the intermediary must make clear as a minimum all the following points for Inland Revenue to be satisfied that sufficient authority to act has been obtained.

    The authority to act must:

    - authorise the intermediary to obtain the client's information from Inland Revenue through all channels, including IR's online services;
    - state the name of the tax agency and/or individual intermediary's name, plus whether staff or contractors may be acting on behalf of the client;
    - state what tax accounts the intermediary will be undertaking on behalf of the client (the online intermediary may wish to specify "ALL" tax accounts to ensure full understanding of the client's tax position);
    - specify the time for which the authority to act endures and how and when the authority to act can be terminated by either party;
    - state to the client that linking allows the intermediary to have full access to information held by Inland Revenue and ability to modify client details relating to the tax accounts they are linked for;
    - state where correspondence for linked tax accounts will be directed, either to the online intermediary or the client;
    - state that authority is given for any refund credits to be transferred to the agency's trust account prior to refund to the client (if applicable);
    - authorise the online intermediary to prepare, submit and sign tax returns on behalf of the client.

    Each point above must have its own "tick box" so the client is fully aware of the agreement they are entering into when authorising authority to act to the intermediary.

    The authority to act points must be agreed to separately from the online intermediary's terms and conditions or contract agreement. A copy of the client's authority to act must be held on file along with the verification of identity.

Electronic signature

37. Inland Revenue will accept an electronic signature on an authority to act obtained electronically if the electronic signature meets the following requirements:

    - the electronic signature must adequately identify the signatory and adequately indicates the agreement to the authority to act;
    - the means of creating the electronic signature must be linked to the signatory and to no other person;
    - the means of creating the electronic signature was under the control of the signatory and of no other person; and
    - any alternation to the authority to act or to the electronic signature after the time of signing must be detectable.

Process for verifying the identity of the person giving authority when onboarding electronically

38. When the onboarding process is done entirely online, it is important that the identity of the person giving authority is verified. Inland Revenue must be satisfied that the information to be accessed belongs to the person giving the authority, or that the person can authorise access of information on behalf of a non-individual (for example, a director of a company).
39. Inland Revenue acknowledges that many of the intermediaries will already have identity verification obligations under the Anti Money-Laundering and Countering Financing of Terrorism Act 2009 (AML-CFT Act). Inland Revenue will accept the identity of the person providing the authority will have been established to a high degree of confidence where the intermediary has completed the customer due diligence in accordance with their obligations under the AML-CFT Act.
40. If an intermediary that does not have due diligence obligations under the AML-CFT Act then they must follow the process set out below in [41]–[51] to verify the identity of their client.

Use of online identity verification provider

41. An intermediary should use an online electronic identity verification provider to verify the identity of a client. The identity verification provider must be reliable and independent and compliant with the AML-CFT identity verification requirements.

42. If an online identity verification provider does not meet the AML-CFT Act requirements (because the intermediary does not have due diligence obligations under the AML-CFT Act), the provider used must be reputable and be authorised to verify at least five points from a current New Zealand driver's licence or a current New Zealand passport. They must also be able to confirm that the driver's licence/passport is a valid one and has not been reported stolen or cancelled. The points for verification must include:

Driver's licence	NZ Passport
First name	First name
Middle name (if given)	Middle name (if given)
Last name	Last name
Driver's licence number	Passport number
Version number	Expiry date

For the identity to be accepted as verified, all five points must match. The third-party verifier is required to send the intermediary a confirmation report advising whether verification has been successful. The confirmation report must state accepted or rejected next to each key point and include the name of the third-party verifier, and the time and date the verification report was requested and completed.

43. The confirmation report is to be held on file by the intermediary as verification of the client's identity. The intermediary must be able to provide a hard copy of the verification report at the request of the Commissioner.

44. Where a confirmation report comes back as unsuccessful, a second attempt may be made. If in the second instance a confirmation report comes back as unsuccessful, the intermediary must then request and keep a copy of the client's photo ID.

45. As the intermediary does not receive an actual copy of the client's photo identification using this process, a bank account match must also be completed. The client must provide the intermediary with a bank account under the name submitted as part of the identity verification. Joint bank accounts are acceptable, where the joint account name includes that provided during the verification process. Details of bank account name and number must be held on file alongside the verification report of client identity. The process of bank account matching reduces the risk of identity fraud.

46. The following are acceptable forms of photo ID:

- New Zealand passport.
- New Zealand driver's licence.
- Overseas passport issued by a foreign government.
- New Zealand certificate of identity (issued by Ministry of Business, Innovation and Employment or Department of Internal Affairs).
- New Zealand firearms licence or dealer's licence.
- New Zealand 18+ card or Kiwi Access card.
- International Drivers' Permit (issued by a member country of the UN Convention on Road Traffic).

47. If the client is a child under 16 years of age, the child's parent or guardian is required to provide the following documentation:

- proof of their own identity as parent or guardian by providing one legible copy of an identity document which must contain a photo as listed in paragraph 47, plus either
  - The child's New Zealand full birth certificate or overseas birth certificate, or
  - a legible copy of a document which shows the relationship between them and the child, such as a birth certificate or adoption papers.

Requirement to keep record of the client's authority to act and identity document

48. The intermediary must keep a copy of the client's authority to act and identity document.

49. Client authorities to act that are obtained electronically must be kept in a manner that allows Inland Revenue to readily access and review that authority and the identification documents of the person who provided the authority.

50. Please refer to Standard Practice Statement SPS 21/02: *Retention of business records in electronic format, application to store records offshore and application to keep records in Languages other than English or te reo Māori* (or any subsequent replacement) for the standards to which records must be kept.

Consequence of not obtaining sufficient authority to act

51. The authority received by the intermediary must be adequate for them to act for the client's tax affairs and social policy entitlements and to receive information held by Inland Revenue (for example, if the intermediary is dealing with the client's PAYE then the client's authority must cover PAYE).
52. Not obtaining sufficient authority to act means that the intermediary is unable to receive the client's information from Inland Revenue.
53. Accessing a client's information without authority or in breach of the authority could result in the removal of the intermediary from the list of tax agents or the cancellation of the intermediary's representative status.

Inland Revenue may audit authority to act documents

54. From time to time, Inland Revenue will ask to view a sample of the authorities to act from an intermediary to ensure the requirements set out in these guidelines are met. Samples will be selected at random.
55. Part of this review may include viewing samples of the identity documents held and to ensure that reasonable checks have been undertaken to establish the identity of the person giving authority, as well as checking if an electronic signature had been submitted in accordance with these guidelines.
56. If an authority to act is held by an intermediary but does not meet the requirements of these guidelines, adequate time will be given to the intermediary to correct this. However, if no authority to act is held for a client at all, that client will be delinked.

Please note – the following is a template of an authority to act. As there is no scripted authority form this is an example only:

Authority to act

Authority is given to (*insert name of business here*) .....and staff and contractors (if applicable) to act on behalf of the entities listed below to obtain information from Inland Revenue about (tick one):

☐ ALL tax types (This will allow your tax preparer to view all correspondence and update your address) *or*

☐ The following tax types: (*list tax types here*) _____

This includes authority to obtain information from Inland Revenue through all channels (including electronic)

☐ For tax agents only - authority is given for overall permission across my tax information

☐ Authority is given to redirect any refunds to the agents trust account for the entries listed below

☐ Authority is given to sign on behalf of the entities listed below

Individual:

Full name	IRD#	Signature	Date

- *An adult is able to sign on behalf of a child under 16, when the child turns 16, they are required to sign an A2A themselves*

Non-Individual:

Entity's name	Entity's IRD#	Representative's name	Representative's position	Signature	Date

This Statement was signed on 6 July 2022.

Rob Falk
Technical Lead, Legal Services – Technical Standards

INTERPRETATION STATEMENT

This section of the *TIB* contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

In most cases Inland Revenue will assess taxpayers in line with the following interpretation statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of the assessment we consider that the earlier advice is not consistent with the law.

IS 22/03: Income tax – Application of the land sale rules to co-ownership changes and changes of trustees

All legislative references are to the ITA unless otherwise stated.

Summary

1. This Interpretation Statement considers whether the land sale rules in the ITA (ss CB 6A to CB 15 and CZ 39) apply to changes to co-ownership of land and changes of trustees of a trust.
2. This Interpretation Statement concludes that the ordinary meaning, case law and legislative history and context indicate that "disposal" in the land sale rules:
   - requires complete alienation of the land by the disposer – the land must be 'got rid of' by the person;[1]
   - requires dealing with the land – so that one person loses ownership of the land and another[2] gains it (or gains a corresponding interest in respect of the same underlying land).

   As such, in the Commissioner's view, "disposal" in the land sale rules **does not include** transfers to self (in the same capacity).[3]
3. In terms of the transactions considered in this Interpretation Statement, this means that:
   - A change to the form of co-ownership, where the proportional shares or notional shares do not change, will not be a "disposal" for the purposes of the land sale rules.
   - If there is a transfer between co-owners where neither's interest is fully alienated but the proportional share or notional share of a co-owner is reduced, there would be a "disposal" for the purposes of the land sale rules by that person to the extent their interest is reduced. This is because while they have not fully alienated the whole estate or interest they had in the land, they have fully alienated part of their interest in land.
   - If there is a transfer that adds a new co-owner, there would be a "disposal" for the purposes of the land sale rules to the extent the share (or notional share) of the original owner(s) in the land is reduced.
   - If there is a transfer that removes a co-owner, there would be a "disposal" by the departing co-owner of their share (or notional share) in the land.
   - A transfer of land on a change of trustees of a trust will not be a disposal for the purposes of the land sale rules. The ITA treats all of the trustees of a trust as essentially a single person, and "disposal" in the land sale rules does not include transfers to self (in the same capacity).

[1] Though this does not mean there could not be a deemed disposal, applying the *Sharkey v Wernher* principle – see further footnote 42.

[2] Which would include the same person in a different capacity.

[3] But again, see footnote 42.

4. Table 1 below sets out examples of these conclusions:

Table 1 – Is there a "disposal" for the purposes of the land sale rules?

Example scenario	Is there a "disposal" for the purposes of the land sale rules?
Change to form of co-ownership only A change to co-ownership from 50:50 tenants in common to joint tenants, or vice versa (same two owners).	No.
Change to proportionality of co-ownership A change to co-ownership from A and B as either 50:50 tenants in common or joint tenants to tenants in common, A as to 25%, B as to 75%.	Yes – disposal by A of an interest in the land as to 25%.
Addition of a co-owner A change to co-ownership from A and B as equal co-owners (either joint tenants or 50:50 tenants in common) to A, B and C as equal co-owners (either joint tenants or tenants in common as to ⅓ each).	Yes – disposal by A of a ⅙ interest in the land to C, and disposal by B of a ⅙ interest in the land to C.
Removal of a co-owner A change to co-ownership from A, B and C as equal co-owners (either joint tenants or tenants in common as to ⅓ each) to A and B as equal co-owners (either joint tenants or 50:50 tenants in common).	Yes – disposal by C of a ⅙ interest in the land to A, and disposal by C of a ⅙ interest in the land to B.
Transfer of land on change of trustee Transfer of land to reflect that there has been a change of trustees of a trust which owns the land.	No.

5. By way of summary, the main reasons for the above conclusions are that:

- The ITA contains various definitions of "dispose". The one that is relevant for the land sale rules requires consideration of the ordinary meaning of "dispose". The courts have noted that "dispose" may have a very wide meaning, but that the context in which the word is used is key to determining the meaning it should be given.
- In the Commissioner's view, the ordinary meaning, case law and legislative history and context indicate that "disposal" in the land sale rules requires the characteristics set out at [2]. In particular, this is because:
  - Consistent with dictionary definitions, at the most fundamental level a disposal involves complete alienation from the disposer of the property being disposed of. That is, the property is "got rid of" – being no longer in the control or possession of the disposer in any capacity.
  - Nothing in the history of the land sale rules suggests they were ever intended to apply to something that may technically be a 'disposal' for property law purposes but does not involve any dealing with land (ie, ownership moving from one person to another).
  - There are contextual indications in the land sale rules that support this view – in particular:
    - the heading to subpart CB – income from business or trade-like activities – which seems consistent with a view that the land sale rules are intended to apply where there is some kind of dealing with land; and
    - the existence of s CB 6A(3B) – which ensures the 'bright-line clock' does not re-start when title is transferred because the trustees of a trust change. In the Commissioner's view, it would be anomalous to consider that Parliament intended that the mechanical transfer in this situation, with no change in the legal or equitable ownership of the underlying land, would be ignored for the purposes of the bright-line clock but could itself trigger the application of the bright-line test.

Introduction

6. The Commissioner has been asked to clarify her position on whether the land sale rules in the ITA (ss CB 6A to CB 15 and CZ 39) apply to changes to co-ownership of land and the transfer of land on a change of trustees of a trust. In particular, the Commissioner has been asked whether these transactions involve a "disposal" of land, for the purposes of the land sale rules.
7. The question of whether there is a "disposal" in these situations is key to whether a tax liability may arise. This matter is often raised in the context of the bright-line test for residential land (s CB 6A), but is also relevant to the other land sale rules.
8. Often, there will be no actual "amount" derived from transactions to effect a change in co-ownership. However, if there is a "disposal", and it is for less than market value consideration, the ITA may deem the person who disposed of the land to have derived an amount equal to the market value of the land at the time of the disposal (s GC 1). This means that if there is a "disposal", there could be "income" from the transaction under one of the land sale rules, whether an actual amount was derived from it or not.

Transactions considered in this Interpretation Statement

9. This Interpretation Statement considers whether there is a "disposal" for the purposes of the land sale rules in the following situations:
   - The form of co-ownership of land changes (ie, from a tenancy in common to a joint tenancy, or vice versa) with no change in the proportional or notional proportional share of the parties.

     For example, co-owners hold the land as 50:50 tenants in common and then move to holding it as joint tenants (who have an equal notional share).
   - The proportional or notional proportional shares of co-owners of land change, whether or not the form of co-ownership changes.

     For example, co-owners hold the land as 50:50 tenants in common and then move to holding it as 75:25 tenants in common.
   - A land transfer is registered on a change of trustees of a trust.
10. This Interpretation Statement also explains when the bright-line 'clock' starts in these situations.

Background to the different forms of co-ownership

11. Before considering whether co-ownership changes give rise to "disposals" for the purposes of the land sale rules, the following discussion explains what joint tenancies and tenancies in common are, and how changes to co-ownership are effected.

What are joint tenancies and tenancies in common?

12. Co-ownership of land is when two or more persons are entitled to the same parcel of land at the same time (concurrently).[4]
13. New Zealand law recognises three types of co-ownership: joint tenancies, tenancies in common, and co-ownership under the Joint Family Homes Act 1964.
14. This Interpretation Statement considers only joint tenancies and tenancies in common, as they are by far the most common forms of co-ownership.

Joint tenancies

15. A joint tenancy arises when land is transferred between persons, or devised by will to two or more persons, without words of severance (that is, without any words to show they are to take distinct and separate shares in the land).[5]
16. A joint tenancy has two essential attributes or features: the right of survivorship (see [17]), and the existence of the "four unities" (see [18]).[6]
17. The right of survivorship means that on the death of one of the joint tenants, their interest is extinguished and accrues to the others. If there were more than two joint tenants, this continues until there is only one survivor, who then holds the land as sole owner.

[4] T Bennion, D Brown, R Thomas and E Toomey, *New Zealand Land Law* (2nd edition, Wellington, Brookers, 2009), at [6.1.01].

[5] DW McMorland and others, *Hinde McMorland and Sim Land Law in New Zealand* (online ed, LexisNexis, accessed 25 August 2021), at [13.004].

[6] Ibid, at 13.004 and *New Zealand Land Law*, at [6.3.01].

18. The "four unities", required for a joint tenancy to exist, are:[7]
    - **Unity of possession**, which means no joint tenant has an exclusive right to possession of any particular part of the land – each is equally entitled to all of it.
    - **Unity of interest**, which means the joint tenants hold a single estate – the interest held by each is the same in extent, nature and duration.

      So for example, there cannot be a joint tenancy between persons holding different interests (for example, a freehold and a leasehold), or between persons with interests of different duration (for example, a life tenant and a reversioner).
    - **Unity of title**, which means all the joint tenants must have derived their title from the same instrument.
    - **Unity of time**, which means the estate of each joint tenant must have become vested at the same time.

19. Joint tenants together constitute a single owner, each with an entitlement to the whole property as long as the joint tenancy exists. But they each have a prospective or "notional"[8] equal and separate share, and the inalienable right to sever their share during their own lifetime. The severed share is then an equal fraction of the whole. For example, if there were two joint tenants each will have a half, and if one of four joint tenants severs their share they will have a quarter (the remaining co-owners will continue to hold as joint tenants unless they have also severed their share).[9] Severing a joint tenancy brings it to an end, and the parties then hold the land as tenants in common.

Tenancies in common

20. Co-owners holding land as tenants in common hold undivided shares in the same parcel of land – each with a present entitlement to a distinct share.[10] It has been said:[11]

> Each tenant in common is entitled to the possession of the whole of the land, and yet, unlike a joint tenant, is entitled only to a distinct share thereof, a combination of concepts possible only because the physical boundaries of his share, called an undivided share, have not yet been determined.
>
> [Footnotes omitted]

21. A tenancy in common can be created in three ways:[12]
    - expressly, by a disposition that includes words of severance, indicating that the co-owners are to have separate shares in the property;
    - by implication of equity – in situations where equity would presume joint tenants at law hold the beneficial interest as tenants in common (for example, where purchasers provide the purchase money in unequal shares); or
    - by severance of a joint tenancy (which may be at law or in equity).

22. There is no right of survivorship if land is held by co-owners as tenants in common, and only the unity of possession is essential for a tenancy in common.[13]

Changes to the form and/or proportionality of co-ownership

23. The form of co-ownership can be changed – either legally or equitably. A legal change in the nature of co-ownership requires registration of the appropriate instrument (ie, an instrument of transfer). Where this has not occurred, a transaction may nonetheless be effective in equity.[14]

[7] *Hinde McMorland and Sim Land Law in New Zealand*, at [13.006], and *New Zealand Land Law*, at [6.3.02].

[8] *Hinde McMorland and Sim Land Law in New Zealand*, at [13.013], *New Zealand Land Law*, at [6.2.02], and *Dewhurst v Conning* (FC Waitakere FAM-2006-090-002333, 4 September 2008).

[9] *New Zealand Land Law*, at [6.2.02].

[10] *Hinde McMorland and Sim Land Law in New Zealand*, at [13.015] and *New Zealand Land Law*, at [6.5.01].

[11] da Costa, D Mendes, "Co-ownership under Victorian land law" (1961) 3 *Melbourne University Law Review* 137 at 167.

[12] *Hinde McMorland and Sim Land Law in New Zealand*, at [13.014], and *New Zealand Land Law*, at [6.5.01].

[13] *Hinde McMorland and Sim Land Law in New Zealand*, at [13.016], and *New Zealand Land Law*, at [6.5.01] – [6.5.02].

[14] ie, it may sever the equitable joint tenancy, with the result that the legal co-owners hold the legal title as joint tenants on trust for the beneficial owners as tenants in common (see *New Zealand Land Law*, at [6.4.08]).

24. Severance of a joint tenancy can be effected by a joint tenant transferring their interest to themself. Where that is done, only the party severing the joint tenancy is entered in the transfer instrument as the transferor – ie, the transferor will be shown as "A", and after the transfer the land will be held as "A ½, B ½". However, it is also possible for both of the parties[15] to be transferors. In that case, the register of land[16] will show a transfer from "A + B" to "A ½, B ½".
25. The co-owners' proportional share (or notional proportional share) can also be changed. For example, "A" and "B" hold land as tenants in common – "A" as to ¼, "B" as to ¾ – but later change this so they hold the land as 50:50 tenants in common. Or, co-owners who held land as joint tenants (each with a prospective (or notional) equal and separate share, as noted at [19]) then change this so they hold the land as tenants in common in unequal shares (for example, "A" as to ⅔ "B" as to ⅓).

What is "land" for tax purposes?

26. So what land do the land sale rules potentially apply to? The definition of "land" in s YA 1 of the ITA says that "land" includes "any estate or interest in land". The term "*estate or interest in land*" is then defined as follows:

> ***estate*** in relation to land, ***interest*** in relation to land, ***estate or interest in land***, ***estate in land, interest in land***, and similar terms—
>
> (a) **mean an estate or interest in the land, whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder;** and
>
> (b) include a right, whether direct or through a trustee or otherwise, to—
>
> (i) the possession of the land (for example: a licence to occupy, as that term is defined in section 122 of the Land Transfer Act 2017):
>
> (ii) the receipt of the rents or profits from the land:
>
> (ii) the proceeds of the disposal of the land; and
>
> (c) do not include a mortgage
>
> [Emphasis in para (a) added]

27. The disposal of any estate or interest in land (legal or equitable) is, therefore, potentially within the scope of the land sale rules. Most dealings in land involve transfers of title to the legal estate, so the examples in this Interpretation Statement all involve transfers of legal title. But the conclusions would be equally applicable to transfers of equitable interests in land.

Are different forms of co-ownership different "interests in land"?

28. As discussed above, there are different rights and incidents arising from joint tenancies than there are from tenancies in common – namely, whether the right of survivorship exists and whether the owners have separate and distinct shares in the land. But does that mean that a change to the form of co-ownership amounts to co-owners having a different "interest in land" to what they had before?
29. The main part of the definition of "estate or interest in land" (set out at [26]) is para (a), which says the term means "an estate or interest in the land, whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder".
30. In the Commissioner's view, para (a) of the definition of "estate or interest in land" is referring to **proprietary estates or interests** in land. The Commissioner does not consider that "interest in land" is broad enough to encompass the particular rights or incidents of the *manner of co-ownership* of a particular estate or interest. This view is supported by the words "whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder". Those terms all reference different proprietary interests in land, and none references anything non-proprietary; such as the rights and incidents that flow from the manner in which a particular estate or interest is co-owned.

[15] Or all of the parties if there are more than two.

[16] The register of land is subject to the Land Transfer Act 2017. It is kept by the Registrar-General of Land (who is appointed under the LTA).

31. The Commissioner's view that "estate or interest in land" is referring to the different proprietary interests one may have in land is consistent with the ordinary meaning of "estate" or "interest" in land. For example, the *Dictionary of New Zealand Law*[17] defines "interest in land" (relevantly) as:

> 2. A property right in land that is not an estate. An interest in land is therefore not classified according to its duration. As a proprietary right, it must be definable, permanent or stable, identifiable by third parties and capable of assumption by third parties.

defines "interest" as:

> 1. A right or title to, or estate in, any real or personal property.

and defines "property" as:

> 1. A thing owned; that over which title is exercised, whether tangible or intangible, real or personal. The (NZ) Property Law Act 2007 s 4, provides that property means everything that is capable of being owned, whether it is real or personal property, and whether it is tangible or intangible property; and includes any estate or interest in property. See also the (NZ) Protection of Personal and Property Rights Act 1988.
>
> 2. A title to or right of ownership in goods or other property. See the (NZ) Sale of Goods Act 1908 s 20.

32. Accordingly, the Commissioner does not consider that the form of co-ownership of land is itself an "interest in land", as "estate or interest in land" is referring to the different proprietary interests that may be held in land (things that can be owned), not the ways in which those interests may be held or owned.

33. It follows from this that, in the Commissioner's view, if co-owners hold land as joint tenants and then transfer it to themselves as tenants in common (or vice versa), they do not each then have different interests in land to what they previously had. Rather, they have the same interest in land (for example, the estate in fee simple) but the *manner in which they hold that interest* (the form of co-ownership) has changed – and different consequences flow from that.

34. The question then arises as to whether the transfer under the Land Transfer Act 2017 (the LTA) from the owner or owners to themself or themselves,[18] to change the form of co-ownership of the land, is a disposal **for the purposes of the land sale rules in the ITA**. Specifically, does "disposal" require alienation of or dealing with the property (ie, disposal to someone who did not previously own it), or is 'disposal to self' caught?

What is a "disposal" of land?

35. The land sale rules may apply if a person **derives an amount** from **disposing of land**.

36. As noted at [8], if no actual amount is derived, the person disposing of the land may be treated as having derived an amount (equal to the market value of the land). So the land sale rules may apply whether the land is sold or otherwise disposed of.

What is the definition of "dispose" in the ITA?

37. The ITA does not set out a comprehensive definition of "dispose" for the land sale rules. It just says that for the land sale rules, "dispose" includes compulsory acquisitions and mortgagee sales – things that would not necessarily otherwise be considered "disposals".

38. So aside from those specific inclusions, "dispose" in the land sale rules just takes its ordinary meaning.

What is the ordinary meaning of "dispose" and what does the case law say?

39. The *Oxford English Dictionary*[19] defines "disposal" and "dispose" (relevantly) as follows:

> **disposal, n.**
>
> …
>
> **2.** The action of disposing of, putting away, getting rid of, settling, or definitely dealing with.
>
> **3.**
>
> **a.** The action of bestowing, giving or making over; bestowal, assignment.

[17] *Dictionary of New Zealand Law*, (Online ed, LexisNexis New Zealand, accessed 25 August 2021).

[18] Depending on the way the transfer is recorded in the transfer instrument (see [62]).

[19] *Oxford English Dictionary*, (Online ed, Oxford University Press, accessed 25 August 2021).

> **b.** Alienation, making over, or parting with, by sale or the like.
>
> **dispose, v.**
>
> **1.**
>
> …
>
> †**c.** *gen*. To dispose of, deal with in any way.
>
> …
>
> **8.** *to dispose of* (with indirect passive to *be disposed of*).
>
> …
>
> **b.** To put or get (anything) off one's hands; to put away, stow away, put into a settled state or position; to deal with (a thing) definitely; to get rid of; to get done with, settle, finish. …
>
> **c.** To make over or part with by way of sale or bargain, sell.

40. The *Dictionary of New Zealand Law*[20] has the following definitions:

> **dispose**
>
> Pass into the control of another person, alienate, relinquish, part with or get rid of.
>
> **disposition**
>
> The distribution or transfer of property or money to someone, especially by bequest.

41. The words "dispose", "disposal", and "disposition" have been discussed in numerous cases in New Zealand and overseas, in taxation and other contexts. The courts have said that these words are of the widest application and are expressions of the widest import.[21]

42. In *Henty House Pty Ltd (in vol liq) v FCT* (1953) 88 CLR 141 (HCA), the court observed (at [7]) that the words "is disposed of" are wide enough to cover all forms of alienation.[22] The court also said (at [7]) that the expression "disposed of" embraces every event by which the property ceases to be available for the use of the taxpayer – because it ceases to be the taxpayer's, be accessible by the taxpayer, or exist.

43. In *Equity Trustees Executors & Agency Co Ltd v Commr of Probate Duties* (1976) 135 CLR 268 (HCA), Stephen J observed (at 273) that "in any disposal of ownership one person loses title and another gains it".[23]

44. However, the context in which the words "dispose" and "disposition" are used is key. The courts have noted that the features or characteristics of "disposal" that are relevant *depend on the context* in which the question of whether there has been a disposal is being considered. In *Griffiths v Ellis* [1958] NZLR 840 (SC), Henry J said (at 868):

> … The words "dispose" and "disposition" are equivocal and their meaning depends upon the context in which they are used. **They may mean, and be confined to, an actual transfer of an interest in land to some other person.** An example of this may be found in *Astley v Manchester, Sheffield & Lincolnshire Railway Co.* (1858) 2 De G. & J. 453; 44 E.R. 1065. On the other hand it was said in *Carter v Carter* [1896] 1 Ch. 62 that they are not technical words but ordinary English words of wide meaning, which, **where not limited by the context, are sufficient to extend to all acts effectively creating a new interest in property whether legal or equitable** (ibid., 67).
>
> [Emphases added]

45. Henry J also stressed the importance of the statutory context when analysing the words "dispose" and "disposition", observing that their meaning must accord with the overall tenor of the legislative provision in order not to make it nugatory.

46. So the case law shows, consistent with the dictionary meanings set out at [39] and [40], that at the most fundamental level a disposition (or disposal), involves complete alienation from the disposer of the property being disposed of. The property is "got rid of" – being no longer in the person's control or possession. But "dispose" can have broader or narrower meanings, depending on the particular context in which it is used.

[20] *Dictionary of New Zealand Law*, (Online ed, LexisNexis New Zealand, accessed 25 August 2021).

[21] *Duke of Northumberland v A-G* [1905] AC 406 (HL) at 411; *Rose v FCT* (1951) 84 CLR 118 (HCA).

[22] Citing the words of Dixon and Fullagar JJ from *FCT v Wade* (1951) 84 CLR 105 (HCA) at 110.

[23] Cited by Hill J in *FCT v Cooling* (1990) 90 ATC 4,472 (FCAFC).

47. It is, therefore, necessary to consider whether the legislative context of the land sale rules requires the term "disposal" to be given a particular meaning for the purposes of those rules. In addition to the meaning of "dispose" being context dependent, s 5 of the Interpretation Act 1999 requires that the meaning of an enactment must be ascertained from its text and in light of its purpose.

Is there a disposal in even the broadest sense where the form of co-ownership changes but the proportional shares or notional shares do not change?

48. Before getting to whether the context of the land provisions indicates a particular meaning be given to "disposal", it is worth commenting that, arguably, there is not a disposal even in the broadest possible sense where a joint tenancy is changed to a tenancy in common (or vice versa) and the proportional shares or notional shares do not change.

49. As noted at [32], the Commissioner does not consider that the form of co-ownership of land is itself an "interest in land". So owning land as joint tenants is not a different "interest in land" to owning the same land as tenants in common.

50. But it has been suggested that there is nonetheless a "disposal" on a transfer to change the form of co-ownership. This argument is based on s 56 of the Property Law Act 2007 (the PLA), and the fact that under the Torrens title system[24] a legal interest in land is created or transferred on the act of registration. Section 56 of the PLA says that a person may dispose of property to themself:

> **56 Person may dispose of property to himself, herself, or itself**
>
> (1) A person may dispose of an estate or interest in property to himself, herself, or itself, alone or jointly with some other person.
>
> (2) A disposition to which subsection (1) applies is enforceable in the same manner as a disposition to another person.

51. The PLA defines "disposition" broadly, and as including any transfer (s 4 of the PLA).

52. However, the fact that the PLA provides that a person can dispose of property to themself (and defines "disposition" as including any transfer), and the fact that under the Torrens title system a legal interest in land is created or transferred on the act of registration, does not determine the meaning of "dispose" for all purposes.

53. The application provision of the PLA provides that if a provision of the PLA is inconsistent with a provision in another enactment, the provision in the other enactment prevails (s 8(4)).

54. In the Commissioner's view, the fact that the ITA contains specific definitions of "dispose" and "disposition of property" for the purposes of different provisions in the ITA shows it was intended that the ITA definitions be applicable for ITA purposes, not the definition of "disposition" in the PLA,[25] or the concept of 'disposal to self' provided for in s 56 of the PLA. The s YA 1 definitions overlap with the PLA definition, but they are not entirely consistent with it, which means the definitions in the ITA must prevail.

55. The Commissioner considers that the ordinary meaning of "dispose", which is what is relevant for the land sale rules, is the meaning as ascertained from dictionary definitions and case law, not statutory constructs, like the ability to dispose of property to oneself – a creation of the PLA.

56. In addition, as discussed from [41], the case law shows that the meaning to be given to "dispose" or "disposal" is dependent on the statutory context. If the statutory context of the land sale rules indicates a meaning of "dispose" that is inconsistent with the concept of a 'disposal to self' (which is discussed from [48]), that would show an inconsistency between the land sale rules and s 56 of the PLA. This would mean that the ordinary meaning of "dispose" (that the statutory context indicates) must prevail over the s 56 concept of 'disposal to self'.

57. The Commissioner does not consider that a transfer to self would be within even the broadest possible meaning the case law indicates "dispose" may have. A transfer to oneself would not be recognised at common law. The effect of s 56 of the PLA is to enable such a transfer for the purpose of simplifying the severance of a joint tenancy.[26]

58. As owning land as joint tenants is not a different "interest in land" to owning the same land as tenants in common, in the Commissioner's view there would not be a "disposal" in the ordinary meaning of that word, even in the broadest sense. The

[24] The generally applicable land transfer system in New Zealand.

[25] And it is noted that s 32 of the Interpretation Act 1999 provides that "[p]arts of speech and grammatical forms of a word that is defined in an enactment have corresponding meanings in the same enactment".

[26] As noted in *New Zealand Land Law*, at [6.4.10].

ordinary meaning of "disposal" or "dispose" would not include a disposal to self (with the parties holding the land in the same capacity before and after the transfer, and with proportionality of interests unchanged). In the Commissioner's view, such a transaction would not involve the required **alienation** of the property (for example, the estate in fee simple) that is necessary for there to be a "disposal". In particular, it is noted that:

- Before and after the change to the form of co-ownership, each co-owner has an interest in the whole property (but whether they have a prospective separate share or a present entitlement to a distinct share depends on whether the co-ownership is a joint tenancy or a tenancy in common).
- The Commissioner does not consider that the right of survivorship (the only 'right' that disappears) can be regarded as an "interest in land" as it is not a proprietary interest, but rather a consequence flowing from the form of co-ownership of the proprietary interest in land. As such, the right of survivorship ceasing to exist is not a disposal of an "interest in land".
- Different rights and incidents flow from the different forms of co-ownership, but there is never a time when either party does not have an interest in the land (ie, the estate). "Disposal" requires **total alienation** of the property.

59. It is acknowledged that for tax purposes a person can be treated as having disposed of property to themself (*Sharkey (Inspector of Taxes) v Wernher* [1956] AC 58 (HL)). But that is in contexts like moving property from revenue account to capital account (ie, a change in terms of whether property is within the tax base or not), which is not analogous to what is just a change to the form of co-ownership (where the property remains either in or out of the tax base).
60. There is further support for the Commissioner's view that there is not a "disposal" for the purposes of the land sale rules in *Junior Farms Ltd v CIR* (2011) 25 NZTC ¶20-064 (HC). In *Junior Farms*, it was held that there was no disposal of the legal or equitable title to land as a result of sale and buy-back agreements. Brewer J considered that the sale and buy-back agreements created a constructive trust over the legal title to the land the taxpayer bought back. The legal title in the land the taxpayer was to buy back was conveyed only for the specific purpose of a subdivision being undertaken, but the taxpayer retained beneficial ownership of that land. As such, Brewer J considered that the taxpayer had not disposed of either the legal or equitable title to the land in question, and therefore there could not have been a (re)acquisition of it for the purposes of what is now s CB 6.
61. Similarly, it is considered that the fact an instrument of transfer is registered with LINZ to effect a change to the form of co-ownership does not mean there is a "disposal" of land by the co-owners.
62. As noted at [24], severance of a joint tenancy can be effected by a joint tenant transferring their interest to themself. Alternatively, it is possible for both parties to be recorded as the transferors.
63. However, at no point in the process of transferring the land from the severing party to themself (or from all of the co-owners to themselves) to effect a change to the form of co-ownership do any of the co-owners cease to have either legal or beneficial ownership of the land (ie, the estate), or any proportion of the land (given we are considering a situation where the proportional shares or notional shares remain the same).

Does the context of the land sale rules suggest a particular meaning of "disposal"?

64. As discussed above, it is necessary to look at whether the **context of the land sale rules** suggests that "disposal" has a particular meaning for those purposes.
65. The key question in respect of changes to the form of co-ownership and changes of trustees is whether "disposal" in the land sale rules includes a **'disposal to self'**.

What the history of the land sale rules indicates about their purpose

66. The history of the land sale rules in the ITA and the purpose behind them shed some light on what "disposal" is intended to mean in those provisions. The following is a brief overview of the history to some of the land sale rules – in particular ss CB 6 (the 'purpose or intention' provision) and CB 6A (the bright-line test).
67. New Zealand's income tax legislation has specifically taxed gains from the sale of land since the enactment of the Land and Income Assessment Act 1900.
68. The original provision taxed gains derived from the "purchase, sale, or other disposition of real property, if the taxpayer's ordinary business comprises dealing in such property, but not otherwise".[27]

[27] Section 59(3) of the Land and Income Assessment Act 1900.

69. The Land and Income Tax Act 1916 expanded this scope to also tax profits from the sale or disposition of land "if the property was acquired for the purpose of selling or otherwise disposing of it at a profit".[28] This meant that isolated transactions (not as part of a business of dealing in land) would be taxed. It is clear from *Hansard* that the provision was intended to deal specifically with property speculators.[29]

70. The Land and Income Tax Act 1951 further expanded the scope of the taxation of profits from land by removing the requirement that the purpose must be to dispose of the land "for a profit". The provisions also included personal property from this time, and a "catch-all" to tax profits or gains derived from "the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit".[30] This provision became s 88(1)(c) of the Land and Income Tax Act 1954.

71. In 1973, the land taxing rules were changed[31] to deal with the two issues identified by the Taxation Review Committee in its 1967 report.[32] In particular:

    - removing the "artificial" distinction between 'purpose' and 'intention';[33] and
    - introducing rules to ensure the taxation of sales resulting from profit-making undertakings or schemes that were devised *after* the purchase of the property (irrespective of the purpose or intention when the property was acquired).[34]

72. Difficulties with enforcing the "purpose or intention" provision (s CB 6) led to the introduction of the bright-line test. The bright-line test was intended to be an objective, easy to apply proxy for there being a purpose or intention of disposal (ie, a speculative purpose).[35] The bright-line test was originally introduced with a bright-line period of 2 years.[36] In 2018, this period was extended to 5 years,[37] and in 2021 it was extended again to 10 years.[38]

73. The Commissioner considers that the land sale rules are clearly aimed at taxing disposals of land where there is a land-related business (dealing, development etc),[39] or speculation in land (whether as part of a business or an isolated transaction).[40] There are also provisions dealing with transactions involving associated persons.[41] Where those provisions apply, while the associated person would not have a land-related business and may not have a speculative purpose, those provisions ensure: (1) that associated persons cannot be used to effectively divert income that would be within one of the business or speculation focussed provisions to someone else instead, and (2) that land cannot be transferred out of the tax base via an associated person.

74. The bright-line test was introduced as an objective test to supplement the intention test (s CB 6), given difficulties in enforcing s CB 6 because of the subjectivity of the intention test. Essentially, disposal within the bright-line period is used as a proxy for the kind of dealing in land or speculative purpose that the land sale rules are aimed at.

75. There are also provisions in the Act to ensure that property can't be transferred or disposed of outside the tax base for no consideration or less than market value consideration. If there's a disposal of property outside the tax base (for example by way of gifting, or sale for less than market value consideration), there will be a deemed market value amount derived (ss FC 2 and GC 1).

76. Nothing in the history of the land sale rules suggests it was ever intended they would apply to something that may technically be a disposal for property law purposes but does not involve any dealing with land such as a transfer to someone else.

[28] Section 85(c) of the Land and Income Tax Act 1916.

[29] *Hansard* (3 July 1916) 176 NZPD 396 (discussion on the Land and Income Tax Bill).

[30] Section 10 of the Land and Income Tax Amendment Act 1951.

[31] Made by the Land and Income Tax Amendment Act 1973.

[32] Taxation Review Committee (chaired by LN Ross), *Taxation in New Zealand: Report of the Taxation Review Committee* (Wellington, New Zealand Government, October 1967).

[33] In what is now section CB 6.

[34] Now sections CB 12 and CB 13.

[35] See for example, Minster of Revenue (Hon Todd McClay), *Taxation (Bright-line Test for Residential Land) Bill: Commentary on the Bill* (Wellington, Inland Revenue, 2015).

[36] By way of the Taxation (Bright-line Test for Residential Land) Act 2015.

[37] By way of the Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Act 2018.

[38] By way of the Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Act 2021.

[39] Section CB 7.

[40] Sections CB 6A, CB 6, CB 12 and CB 13.

[41] Sections CB 9(2), CB 10(2), CB 11 and CB 15.

77. There are contextual indications in the land sale rules that support this view – in particular the heading to subpart CB and the existence of s CB 6A(3B), both of which are touched on below.

The heading to subpart CB

78. The heading to subpart CB of the ITA (which contains the land sale rules) was inserted in 1994, and then read "Activities in the nature of trade". It was changed to "Income from business or trade-like activities" in 2004 as part of the process of the ITA being rewritten for improved clarity (which was done progressively from 1994).

79. In the Commissioner's view, the heading to subpart CB indicates that the provisions in subpart CB are concerned with amounts that may be *likened in some way* to business or trade income, even if they cannot be classified as business or trade income. This would include amounts from a speculative or profit-making purpose or undertaking. The associated persons provisions are concerned with taxing amounts that may be likened in some way to business or trade income, but the income is diverted to someone else instead.

80. The heading to subpart CB seems consistent with the apparent intention behind the land provisions – that they are intended to tax disposals of land where there is a land-related business or speculation in land. While of not much weight, this contextual clue seems consistent with a view that the land sale rules are intended to apply where there is some kind of dealing with land (ie, ownership moving from one person to another), and that they are not intended to capture a disposal that is just a mechanical transfer from an owner to themselves (in the same capacity), which cannot in any sense be considered a dealing with land.[42]

Specific provision that ensures the bright-line clock does not re-start

81. Another contextual indication that "dispose" in the land sale rules (in particular the bright-line test) is not intended to include a 'disposal to self' is the existence of s CB 6A(3B).[43] This provision ensures the 'bright-line clock' does not re-start when title is transferred because the trustees of a trust change.

82. If "dispose" in the bright-line test included 'disposal to self', the transfer of title on a change of trustees would be a disposal and a taxing event (if within the bright-line period).

83. It would be anomalous to suggest Parliament specifically legislated for the bright-line clock not re-starting in this situation, but nevertheless intended the transfer on a change of trustees to be a 'disposal' that could be subject to tax.

84. Therefore, the existence of what is now s CB 6A(3B) provides a contextual indication that 'disposal' in the context of the bright-line rules (and by logical extension the other land sale rules) is not intended to include the mechanics of changes in title where no change in ownership of the equitable or legal estate occurs.

Conclusion on what "disposal" means in the land sale rules

85. In the Commissioner's view, the ordinary meaning, case law, and legislative history and context indicate that "disposal" in the land sale rules:

- requires complete alienation of the land by the disposer – the land must be 'got rid of' by the person;[44]
- requires dealing with the land – so that one person loses ownership of the land and another[45] gains it (or gains a corresponding interest in respect of the same underlying land).

As such, in the Commissioner's view, "disposal" in the land sale rules **does not include** transfers to self (in the same capacity);[46]

86. The following discussion looks at what this conclusion means for changes to co-ownership.

[42] Though this does not mean there could not be a deemed disposal, applying the *Sharkey v Wernher* principle. However, it may be that the *Sharkey v Wernher* principle applies only in relation to some land provisions (for instance, the Commissioner does not consider that it could apply in the context of s CB 6, which turns on the taxpayer's purpose or intention **on acquisition** of land, and a change of intention does not take the land out of the tax base).

[43] And s CZ 39(6) – the equivalent provision for the 5-year bright-line test.

[44] Though this does not mean there could not be a deemed disposal, applying the *Sharkey v Wernher* principle – see further footnote 42.

[45] Which would include the same person in a different capacity.

[46] But again, see footnote 42.

Is there a "disposal" when the form of co-ownership changes, but the proportional or notional shares do not change?

87. The first transaction to consider is where there is a land transfer to effect a change to the **form of co-ownership** (ie, from a tenancy in common to a joint tenancy, or vice versa) with **no change** in the proportional or notional shares of the parties.

    For example, co-owners hold the land as 50:50 tenants in common and then move to holding it as joint tenants (who have an equal notional share).

88. In the Commissioner's view, a transfer to change the form of co-ownership, where the proportional or notional shares do not change, will not be a "disposal" for the purposes of the land sale rules.

89. In this situation there is no alienation of land by the transferee(s). The co-owners hold the same estate or interest in land before and after the change in co-ownership. At no point do the parties lose control of the property (the estate or interest in land) or any part thereof.

90. There is also no "dealing with" the land – the transfer to effect the change in co-ownership does not involve land (or any part thereof) moving from the one party to another. The change to the form of co-ownership merely alters whether the right of survivorship exists, and whether the co-owners have a present entitlement to a distinct share of the land or a prospective or notional equal and separate share that they have the right to sever during their lifetime. They continue to have an interest in the whole of the property, and the proportionality of their share or notional share does not change.

How does this reconcile with QB 17/09?

We have been asked how this conclusion reconciles with the position in QB 17/09 *Is there a full or partial disposal when an asset is contributed to a partnership as a capital contribution?* The conclusion in QB 17/09 would mean that if land jointly owned by A & B was transferred to a 50:50 partnership of A & B, there would be a full disposal.

There are a number of reasons for the conclusion in QB 17/09, but relevantly for present purposes, it is noted in the QWBA that when an asset is contributed to a general partnership the legal ownership of the asset, its juristic character, and the person's interest in the asset all fundamentally change. Before the contribution, the person is the owner of the asset. After the contribution of the asset to the partnership, the asset ceases to be the person's property – it belongs to the partners of the partnership and becomes partnership property. While the partners are treated as each owning the asset in proportion to their partnership interest, they no longer own the asset in their personal capacity.

This is different to a situation where joint tenants sever the joint tenancy to hold the land as 50:50 tenants in common, or where a 50:50 tenancy in common is converted to a joint tenancy. Before and after the transfer to effect the change to the form of co-ownership, each party's interest in the land was owned in their personal capacity. Their proportionate or notional proportionate shares in the land are unchanged. In the Commissioner's view this is different from a situation where land is transfer from A & B jointly to A & B in their capacity as partners in a partnership. In that situation, there is a change in terms of ownership of the land, as it is now partnership property and owned by the partners in their capacity as such.

Does the transfer reset the start date for the bright-line test?

91. The general start date[47] for the bright-line test is the date of registration of the instrument of transfer under the LTA. A legal change to the form of co-ownership requires registration of an instrument of transfer. However, there are specific provisions that ensure the start date for the bright-line test does not reset on the registration of a transfer to effect a change to the form of co-ownership where the proportional or notional shares do not change.[48] These provisions came into force on 27 March 2021. Their effect is illustrated in Examples 1 and 2.

[47] Except for: (1) situations where an instrument to transfer the land to the person is not registered on or before the bright-line date, in which case the start date of the bright-line period will be the date the person acquired the land, and (2) other situations specifically legislated for, such as subdivisions, off-the-plan purchases, and relationship property settlements.

[48] Section CB 6A(5B) and (5C) and s CZ 39(5B) and (5C).

Example 1 – Change from a joint tenancy to a tenancy in common, with no change to the parties' proportional or notional shares

Wiremu and Rebecca started a relationship in 2018. Both have children from previous relationships. In 2019, Wiremu and Rebecca purchased a rental property together as joint tenants. Two years later, they decide that in the event of one of them dying, they want to financially assist their children, so want the share of the partner who dies to go to that partner's children. They submitted a land transfer, which LINZ registered in June 2021, to change their ownership of the property from a joint tenancy to a tenancy in common (50:50).

For the bright-line test (s CZ 39) to apply, there needs to have been a "disposal" of residential land by Wiremu and/or Rebecca. In this case, there **has not been** a disposal of land by either of them.

Wiremu and Rebecca own the same land (the estate in fee simple) before and after the transfer. Before the transfer, they each had an interest in the whole of the property, and a notional equal separate share (ie, 50%) that they had the right to sever during their lifetime. After the transfer, they each still have an interest in the whole of the property, and they now have a present entitlement to a 50% share. No land (or any part thereof) has passed from one party to another.

The bright-line period does not restart on the date in June 2021 when LINZ registered the transfer to change the form of co-ownership of the property; the bright-line period continues to be counted from the date in 2019 when the property was originally transferred to Wiremu and Rebecca.

Example 2 – Change from a tenancy in common to a joint tenancy, with no change to the parties' proportional or notional shares

Mary and Bill are a couple who bought a house in April 2021 as 50:50 tenants in common. They are renting out the house while travelling extensively for at least the next couple of years. Both have children from previous relationships. Some months later, they realise that in the event of one of them dying, the share of the spouse who dies will go to their estate and then to their children, and the surviving spouse may not be able to move into the house should they want to. They decide to change the form of their co-ownership of the property, from a tenancy in common to a joint tenancy, so when one of them dies the other will become the sole owner of the property. They submitted a land transfer, which LINZ registered in September 2021, to change their ownership of the property from tenancy in common (50:50) to a joint tenancy.

For the bright-line test (s CB 6A) to apply, there needs to have been a "disposal" of residential land by Mary and/or Bill. In this case, there **has not been** a disposal of land by either of them.

Mary and Bill own the same land (the estate in fee simple) before and after the transfer. Before the transfer, they each had an interest in the whole of the property, with a present entitlement to a 50% share. After the transfer they each still have an interest in the whole of the property, and they now have a notional equal separate share (ie, 50%) that they had the right to sever during their lifetime. No land (or any part thereof) has passed from one party to another.

The bright-line period does not restart on the date in September 2021 when LINZ registered the transfer to change the form of co-ownership of the property; the bright-line period continues to be counted from the date in April 2021 when the property was originally transferred to Mary and Bill.

Is there a "disposal" when the parties' proportional or notional shares change?

92. The next transaction to consider is where a transfer effects a change in the proportional or notional shares of the parties, (whether or not the form of co-ownership changes – ie, from a tenancy in common to a joint tenancy or vice versa).

    For example, co-owners hold the land as 50:50 tenants in common and then move to holding it as 75:25 tenants in common.

93. In the context of changes to the form of co-ownership, this Interpretation Statement has so far looked only at situations where the co-owners' proportional or notional shares do not change. But is there a "disposal" where **there is a change** in the co-owners' proportional or notional shares (whether or not the form of co-ownership changes)? And if so, to what extent would this be a disposal?

94. In the Commissioner's view, if there is a transfer between co-owners where neither's interest is fully alienated but the proportional or notional share of a co-owner is reduced, there is a "disposal" for the purposes of the land sale rules by that person to the extent their interest is reduced. This is because while they have not fully alienated the whole estate or interest they had in the land, they have fully alienated part of their interest in land.

95. Relevant to this situation is s CB 23B, which provides as follows:

> **CB 23B Land partially disposed of or disposed of with other land**
>
> Sections CB 6A to CB 23, CZ 39, and CZ 40 (which relate to the bright-line test for residential land) apply to an amount derived from the disposal of land if the land is—
>
> (a) **part of the land to which the relevant section applies**:
>
> (b) the whole of the land to which the relevant section applies:
>
> (c) disposed of together with other land.
>
> [Emphasis in para (a) added]

96. Section CB 23B(a) confirms that the land sale rules will apply to the disposal of **part of the land** to which the relevant section applies. This is illustrated in Examples 3 and 4.

Does the transfer reset the start date for the bright-line test?

97. A legal change to the form or proportionality of co-ownership is effected by registration of an instrument of transfer, and the general start date[49] for the bright-line test is the date of registration of the instrument of transfer under the LTA. But there are specific provisions that ensure the registration of a transfer to change the proportionality of co-ownership will result in the bright-line clock restarting only to the extent a particular party's interest has increased.[50] To the extent they already owned the land, the bright-line clock does not reset. These provisions came into force on 27 March 2021. Their effect is illustrated in Examples 3 and 4.

> **Example 3 – Change of the proportional share of co-owners who are tenants in common**
>
> In December 2018, Michaela and Daniel bought a rental property as tenants in common, Michaela as to ½, Daniel as to ½. Daniel's financial position changes in 2021, and he asks Michaela if she is interested in buying out part of his share of the property. She is keen to do this, so she buys half of Daniel's 50% interest at market value. LINZ registers the transfer in April 2021, and the register shows that the land is now held by Michaela as to ¾, Daniel as to ¼.
>
> For the bright-line test (s CZ 39) to apply, there needs to have been a "disposal" of residential land by Michaela and/or Daniel. In this case, there **has been** a disposal of land by Daniel. Daniel has disposed of a ¼ interest in the land. While Daniel's interest in the estate is not fully alienated, his interest as to ¼ is fully alienated.
>
> Before the transfer, Daniel had an entitlement to a distinct share of the land (50%), and after the transfer he has an entitlement to a smaller distinct share (25%). He has completely alienated himself of his interest in the land as to ¼ (or 25%), though he still has an interest in the land. The fact he has not disposed of all the land he had does not mean there has not been complete alienation of part of the land (the ¼ interest).
>
> The amount Daniel sold the ¼ interest to Michaela for is income to Daniel, as the disposal was within the relevant bright-line period (5 years). He can deduct half of the amount he paid for his original 50% share of the property, because he is selling half of his original share.
>
> For the ¼ share of the land Michaela purchased from Daniel, the bright-line period starts on the date in April 2021 that LINZ registers the transfer to effect the sale of that share. The bright-line period does not restart for the 50% interest Michaela has owned since December 2018, nor for the 25% interest Daniel retains.

[49] See footnote 47 on page 23.

[50] Section CB 6A(5D) and s CZ 39(5D).

Example 4 – Change from a joint tenancy to a tenancy in common, with a change to the parties' proportional or notional shares

In January 2019, brothers Simon and Cameron buy a residential rental property as joint tenants. The property was purchased for $900,000, with each contributing $450,000 to the purchase price. Cameron's tourism business takes a considerable hit over 2020/2021, and he wants to sell some of his share in the rental property to try to keep his business afloat until the tourism industry picks up. Simon agrees to buy two fifths (40%) of Cameron's share at market value. The market value of the property is $1.5m, so Simon buys 40% of Cameron's share (an additional 20% interest in the land) for $300,000. LINZ registers the transfer in August 2021, and the register shows that the land is now held by Simon as to seven-tenths (70%), Cameron as to three-tenths (30%).

For the bright-line test (s CZ 39) to apply, there needs to have been a "disposal" of residential land by Simon and/or Cameron. In this case, there **has been** a disposal of land by Cameron. Cameron is regarded as having disposed of a 20% interest in the land. Joint tenants each have a prospective or "notional" equal and separate share, which they can sever during their lifetime. As such, before the transfer, Simon and Cameron each had a notional equal proportional share (50%) that they could sever. In effecting the transfer, the joint tenancy is severed, and afterwards Simon has a 70% share and Cameron has a 30% share. There is a disposal to the extent that Cameron's previous notional proportional share has reduced. While Cameron's interest in the estate is not fully alienated, his previous notional share as to 20% (of the whole) is fully alienated.

The amount Cameron sold the 20% interest to Simon for ($300,000) is income to Cameron, as the disposal was within the relevant bright-line period (5 years). Cameron can deduct 40% of the amount of his share of the purchase price for the property (40% of $450,000 = $180,000), because he is selling 40% of his original share. So Cameron has $120,000 net income from the sale.

For the 20% share of the land Simon purchased from Cameron, the bright-line period starts on the date in August 2021 that LINZ registers the transfer to effect the sale of that share. The bright-line period does not restart for the (notional) 50% interest Simon has owned since January 2019, nor for the 30% interest Cameron retains.

Is there a "disposal" when a co-owner is added or removed?

98. Applying the conclusions reached above, if a transfer adds a new co-owner, there would be a "disposal" for the purposes of the land sale rules to the extent the share (or notional share) of the original owner(s) in the land is reduced. Similarly, if a transfer removes a co-owner, there would be a "disposal" by the departing co-owner of their share (or notional share) in the land.

Does the transfer reset the start date for the bright-line test?

99. The legal addition or removal of a co-owner is effected by registration of an instrument of transfer, and the general start date[51] for the bright-line test is the date of registration of the instrument of transfer under the LTA. But there are specific provisions that ensure that the registration of a transfer to add or remove a co-owner will result in the bright-line clock restarting (or starting) only to the extent a particular party's interest has increased.[52] To the extent someone already owned the land before the addition or removal of a co-owner, the bright-line clock does not reset. These provisions came into force on 27 March 2021. Their effect is illustrated in Examples 5 and 6.

[51] See footnote 47.

[52] Section CB 6A(5D) and s CZ 39(5D).

Example 5 – Adding a new co-owner

Jacob and Zhuo were getting married in March 2020, and Jacob wanted to transfer his rental property (acquired in July 2018) into their joint names. He was advised that if he did this within five years of when the property was transferred to him, there would be bright-line implications. So he decides to wait until August 2023 to transfer the property to himself and Zhuo as joint tenants.

When the property is transferred from Jacob to "Jacob + Zhuo" in August 2023, there will be a disposal of land by Jacob. Jacob will be regarded as having disposed of a 50% interest in the land. Before the transfer, Jacob owns 100% of the land. After the transfer, he and Zhuo will be joint tenants, so they will each have a notional equal proportional share (50%) that they could sever during their lifetime. There will be a disposal to the extent that Jacob's previous 100% interest in the property is reduced – after the transfer he will have a notional 50% share. But if Jacob waits until after the 5-year bright-line period and none of the other land sale rules apply, the disposal will not give rise to any tax consequences for Jacob. If Jacob transfers the property into the couple's joint names within the 5-year bright-line period, Jacob will have to pay tax in respect of the notional 50% share he disposes of to Zhuo, based on the market value of the share (s GC 1) minus a deduction for 50% of the cost of the land to Jacob (ie, 50% of the original purchase and the cost of any capital improvements).

The bright-line period will start for Zhuo on the date in August 2023 that LINZ registers the transfer of the property into the parties joint names (presuming the transfer goes ahead as planned). The bright-line period will not restart for the (notional) 50% interest Jacob will continue to own after the transfer.

Example 6 – Removing a co-owner

Susan, Charles and Donald bought a residential investment property in February 2018, as tenants in common as to ⅓ each. In April 2021, Donald decides he wants to sell his share to Susan and Charles, and they agree to buy out Donald's ⅓ share (buying half of it each). LINZ registered the transfer to effect the sale in May 2021.

When the property is transferred from Susan, Charles and Donald (as tenants in common as to ⅓ each) to Susan and Charles (as tenants in common as to ½ each) in January 2021, there was a disposal of land by Donald. Donald disposed of his ⅓ interest in the land. Because the disposal was outside the relevant 2-year bright-line period and none of the other land sale rules apply, there are no tax consequences for Donald. Had Donald sold his share of the property within the 2-year bright-line period, he would have had tax to pay in respect of the disposal.

For the ⅙ interest each of Susan and Charles purchased from Donald, the bright-line period starts on the date in May 2021 that LINZ registers the transfer to effect the sale and purchase of Donald's ⅓ share of the land. The bright-line period does not restart for the ⅓ interests Susan and Charles have owned since February 2018.

Is there a "disposal" when land is transferred on a change of trustees of a trust?

100. Where land is held in a trust, the trustees are the legal owners of the land. Some or all of the trustees of the trust may change during the existence of the trust. If this happens, the legal title to the land held in the trust would be transferred from the existing trustees to the new trustees.

101. For example, if the trustees of a trust were "A, B and C", and "C" was to be replaced as trustee by "D", the land would be transferred from "A, B and C as trustees of the X Trust" to "A, B and D as trustees of the X Trust".

102. The ITA treats all the trustees of a trust as essentially a single person. This is because of the definition of "trustee" in s YA 1, which provides (relevantly) that:

> ***trustee***,—
>
> (a) for a trust,—
>
> (i) means the trustee only in the capacity of trustee of the trust; and
>
> (ii) **includes all trustees, for the time being, of the trust**:
>
> [Emphasis in para (a) added]

103. Because of this definition, where land is transferred because the trustees of the trust have changed, any "disposal" would have to be a 'disposal to self'.

104. As noted at [85], in the Commissioner's view, "disposal" in the land sale rules does not include transfers to self (in the same capacity). As such, the Commissioner does not consider that a transfer of land on a change of trustees of a trust will be a disposal for the purposes of the land sale rules.

Example 7 – Transfer of land when the trustees of a trust change

A piece of land is held in The Jones Family Trust, so the title is registered in the names of the three trustees – Janice, Jeremy, and Joan. Joan does not want to continue being a trustee, so it is agreed that James will take over from her as a trustee. Once the change of trustees has been effected, a transfer is registered with LINZ, to transfer the title to the land from Janice, Jeremy and Joan as trustees for The Jones Family Trust to Janice, Jeremy and James as trustees for The Jones Family Trust.

The transfer is not a "disposal" of land for the purposes of the land sale rules. For tax purposes, the transfer was from the "trustee" (which includes all trustees for the time being) to the "trustee". The "trustee" has not parted with the land, and has the same interest before and after the transfer. As such, there is not a "disposal" in terms of the land sale rules.

105. The Commissioner has been asked whether there will be a disposal where land is transferred from the trustees of "Trust A" to the trustees of "Trust B", where the trustees of both trusts are the same – ie, whether that would constitute a 'disposal to self' and therefore not a disposal for the purposes of the land sale rules. The Commissioner considers this would be a "disposal". It is not a 'disposal to self', as the trustees are acting in different capacities as trustees of Trust A and trustees of Trust B (just as they are acting in different capacities in their trustee capacities and in their personal capacities). Likewise, there would be a disposal if someone transfers land from themself in their personal capacity to themself as trustee for a trust (for example, "A" disposes of property to "A as trustee for the A Family Trust"). That would not be a 'transfer to self' because of the different capacities.

Does the transfer reset the start date for the bright-line test?

106. There are provisions in the ITA that provide that the bright-line period does not restart on the registration of a transfer instrument to effect a change of trustees (ss CB 6A(3B) and CZ 39(6)). The bright-line start date for the trust will be the date of registration of the original transfer of the land into the trust (provided it has been held in the trust continually since then).

Appendix: Legislation

107. The conclusions in this Interpretation Statement are applicable to all the land sale rules in the ITA. The most commonly relevant provisions are ss CB 6A (the bright-line test) and CB 6 (the intention test), which are set out below along with other relevant legislative provisions.

Income Tax Act 2007

CB 6A Disposal within 10 years: Bright-line test for residential land

When this section applies: relationship with subject matter

(1A) This section applies if none of sections CB 6 to CB 12 apply.

Some definitions

(1) In this section,—

(a) **10-year test land** means residential land to the extent to which, using a land area test, it is not new build land, and the land's bright-line disposal date is within 10 years of the earliest of any of the applicable dates (**bright-line acquisition dates**) described in subsections (3) to (7C):

(b) **5-year test land** means residential land to the extent to which, using a land area test, it is new build land, and—

(i) the person acquires it no later than 12 months after the land becoming **new build land**; and

(ii) the land's bright-line disposal date is within 5 years of the earliest of any of the applicable dates (**bright-line acquisition dates**) described in subsections (3) to (7C); and

(iii) at the time of its disposal or at the time the instrument to transfer the land to another person is registered as described in subsection (3)(a), it meets the requirements of paragraph (a), (b), (d), (e), or (f) of the definition of **new build land** or would have met 1 of those requirements but for the destruction of the relevant place by natural disaster or fire.

Income

(2) Subject to quantification under subsection (8), an amount that a person derives from disposing of residential land is income of the person to the extent to which the amount is for residential land that is—

(a) 10-year test land:

(b) 5-year test land.

...

Change of trustees: disposal

(3B) For the purposes of subsection (3), and despite subsection (3)(a), in the case of a transfer of land to a trustee of a trust from a trustee of the trust, the date on which the relevant instrument was registered is treated as—

(a) the earliest date on which an instrument to transfer the land to a trustee of the trust was registered under the relevant law referred to in the subsection (the first date), if there has been no intervening transfer to a person who is not a trustee; or

(b) the first date following the intervening transfer, if there has been an intervening transfer to a person who is not a trustee.

...

Joint tenancy converted to tenancy in common

(5B) In the case and to the extent to which the residential land is held as a tenant in common in a share equal to all joint owners, acquired subsequent to, and to the extent to which it was previously being held as a joint tenant nominally in the same share equal to the same joint owners, the bright-line acquisition date for the purposes of the definitions of 10-year test land and 5-year test land is the date the joint tenancy was acquired.

Tenancy in common converted to joint tenancy

(5C) In the case and to the extent to which the residential land is held as a joint tenant nominally in a share equal to all joint owners, acquired subsequent to, and to the extent to which it was previously being held as a tenant in common in the same share equal to the same joint owners, the bright-line acquisition date for the purposes of the definitions of 10-year test land and 5-year test land is the date the tenancy in common in equal shares was acquired.

Dividing from and merging with pre-existing land

(5D) To the extent to which land (land A) is either transferred by a person and, before transfer from them, was part of other land (pre-existing land) that a person owned, or is transferred to a person and, after transfer to them, merges with other land (also pre-existing land) that the person owns, an instrument of transfer for the transfer is treated as not being for the pre-existing land.

…

CB 6 Disposal: land acquired for purpose or with intention of disposal

Income

(1) An amount that a person derives from disposing of land is income of the person if they acquired the land—

(a) for 1 or more purposes that included the purpose of disposing of it:

(b) with 1 or more intentions that included the intention of disposing of it.

…

CB 23B Land partially disposed of or disposed of with other land

Sections CB 6A to CB 23, CZ 39, and CZ 40 (which relate to the bright-line test for residential land) apply to an amount derived from the disposal of land if the land is—

(a) part of the land to which the relevant section applies:

(b) the whole of the land to which the relevant section applies:

(c) disposed of together with other land.

…

GC 1 Disposals of trading stock at below market value

When this section applies

(1) This section applies when a person disposes of trading stock for—

(a) no consideration:

(b) an amount that is less than the market value of the trading stock at the time of disposal.

Market value consideration

(2) The person is treated as deriving an amount equal to the market value of the trading stock at the time of disposal.

…

YA 1 Definitions

In this Act, unless the context requires otherwise,—

…

amount—

(a) includes an amount in money's worth: …

…

dispose,—

(a) in sections CB 6A to CB 16, CB 18, CB 19, CB 21, CB 22, CZ 39, and subpart EL (which relate to the disposal of land), for land, includes—

(i) compulsory acquisition under any Act by the Crown, a local authority, or a public authority:

(ii) if there is a mortgage secured on the land, a disposal by or for the mortgagee as a result of the mortgagor's defaulting under the mortgage: …

…

estate in relation to land, **interest** in relation to land, **estate or interest in land, estate in land, interest in land**, and similar terms—

(a) mean an estate or interest in the land, whether legal or equitable, and whether vested or contingent, in possession, reversion, or remainder; and

(b) include a right, whether direct or through a trustee or otherwise, to—

(i) the possession of the land (for example: a licence to occupy, as that term is defined in section 122 of the Land Transfer Act 2017):

(ii) the receipt of the rents or profits from the land:

(iii) the proceeds of the disposal of the land; and

(c) do not include a mortgage

…

land—

(a) includes any estate or interest in land:

(b) includes an option to acquire land or an estate or interest in land:

(c) does not include a mortgage: …

…

trustee,—

(a) for a trust,—

(i) means the trustee only in the capacity of trustee of the trust; and

(ii) (includes all trustees, for the time being, of the trust: …

Property Law Act 2007

4 Interpretation

In this Act, unless the context otherwise requires,—

…

disposition—

(a) means any sale, mortgage, transfer, grant, partition, exchange, lease, assignment, surrender, disclaimer, appointment, settlement, or other assurance; and

(b) includes the creation of—

(i) an easement, profit à prendre, or any other interest in property; and

(ii) a trust in the lifetime of the settlor or by will, and a devise, bequest, or appointment by will in respect of property; but

(c) in subpart 6 of Part 6, has the meaning given to that term by section 345(2)

…

8 Application

(1) This Act applies to the land, other property, and instruments specified in subsection (2) to the extent that the law of New Zealand applies to the land, other property, and instruments.

(2) The land, other property, and instruments are—

(a) land in New Zealand:

(b) other property whether in or outside New Zealand:

(c) instruments whether—

(i) executed in or outside New Zealand; and

(ii) coming into operation before, on, or after 1 January 2008.

(3) This Act does not apply to Māori customary land within the meaning of Te Ture Whenua Maori Act 1993.

(4) If a provision of this Act is inconsistent with a provision in another enactment, the provision in the other enactment prevails.

(5) Without limiting subsection (4), this Act applies subject to the Land Transfer Act 2017.

(6) This section applies subject to any other provision of this Act or of another enactment providing otherwise.

...

56 Person may dispose of property to himself, herself, or itself

(1) A person may dispose of an estate or interest in property to himself, herself, or itself, alone or jointly with some other person.

(2) A disposition to which subsection (1) applies is enforceable in the same manner as a disposition to another person.

References

Case references

Dewhurst v Conning (FC Waitakere FAM-2006-090-002333, 4 September 2008)

Duke of Northumberland v A-G [1905] AC 406 (HL)

Equity Trustees Executors & Agency Co Ltd v Commr of Probate Duties (1976) 135 CLR 268 (HCA)

FCT v Cooling (1990) 90 ATC 4,472 (FCAFC)

FCT v Wade (1951) 84 CLR 105 (HCA)

Griffiths v Ellis [1958] NZLR 840 (SC)

Henty House Pty Ltd (in vol liq) v FCT (1953) 88 CLR 141 (HCA)

Junior Farms Ltd v CIR (2011) 25 NZTC ¶20-064 (HC)

Rose v FCT (1951) 84 CLR 118 (HCA)

Sharkey (Inspector of Taxes) v Wernher [1956] AC 58 (HL)

Legislative references

Income Tax Act 2007

Subpart CB (income from business or trade-like activities), ss CB 6A to CB 15, CB 23B, CZ 39, FC 2, GC 1, and the definitions in s YA 1 of "estate or interest in land", "dispose", "disposition of property", "land" and "trustee"

Interpretation Act 1999

Sections 5 and 32

Property Law Act 2007

Sections 8 and 56, and the definition of "disposition" s 4

Other legislative references

Joint Family Homes Act 1964

Land and Income Assessment Act 1900, s 59(3)

Land and Income Tax Act 1916, s 85(c)

Land and Income Tax Act 1954, s 88(1)(c)

Land and Income Tax Amendment Act 1951, s 10

Land and Income Tax Amendment Act 1973

Taxation (Bright-line Test for Residential Land) Act 2015

Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Act 2018

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

Other references

Bennion, T, Brown, D, Thomas, R, and Toomey, E, *New Zealand Land Law* (2nd edition, Wellington, Brookers, 2009)

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Dictionary of New Zealand Law, (Online ed, LexisNexis New Zealand, accessed 25 August 2021)

Hansard (3 July 1916) 176 NZPD 396 (discussion on the Land and Income Tax Bill)

McMorland, DW and others, *Hinde McMorland and Sim Land Law in New Zealand* (online ed, LexisNexis, accessed 25 August 2021)

Minster of Revenue (Hon Todd McClay), *Taxation (Bright-line Test for Residential Land) Bill: Commentary on the Bill* (Wellington, Inland Revenue, 2015)

Oxford English Dictionary, (Online ed, Oxford University Press, accessed 25 August 2021)

QB 17/09 *Is there a full or partial disposal when an asset is contributed to a partnership as a capital contribution?* (Inland Revenue)

Taxation Review Committee (chaired by LN Ross), *Taxation in New Zealand: Report of the Taxation Review Committee* (Wellington, New Zealand Government, October 1967)

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 22/05: GST – Does zero-rating apply to certain services that airport operators supply to international airline operators?

Question

Does zero-rating apply to garbage disposal, lighting and security, aircraft parking and terminal services that airport operators supply to international airline operators?

Answer

No. The services are standard-rated, not zero-rated.

Explanation

1. "GST on services supplied to international aircraft" *Public Information Bulletin* 173 (April 1988): 11 (**the PIB**) states that the following services (**the relevant services**) supplied by local authorities (who own and operate airports) to international aircraft are standard-rated:
   - garbage disposal;
   - lighting and security;
   - aircraft parking; and
   - terminal fees (for terminal services).
2. The PIB considered that the relevant services were standard-rated because they were not zero-rated under the earlier versions of s 11A(1)(a), (h) and (i).
3. This QWBA reviews the PIB's conclusion in light of court cases and changes to the GST Act that have occurred since the publication of the PIB. Most international airports in New Zealand are now owned and operated by private companies with local council shareholdings.

When services can be zero-rated under s 11A(1)(a)

4. A transaction is zero-rated under s 11A(1)(a) where:
   - there is a supply of services;
   - the supply of services is chargeable with tax under s 8; and
   - the services, not being ancillary transport activities such as loading, unloading and handling, are the transport of passengers or goods:
     - from a place outside New Zealand to another place outside New Zealand;
     - from a place in New Zealand to a place outside New Zealand; or
     - from a place outside New Zealand to a place in New Zealand.

There is a supply of services

5. GST is a transaction-based tax, and the focus is on the supply by a supplier to a recipient in the particular case.[1] The test for determining whether a supply of services is chargeable with GST is what the nature of the supply is.[2]

[1] *Databank Systems Ltd v CIR* (1989) 11 NZTC 6,093 (CA) at 6,103–6,105.

[2] *Databank* (CA) at 6,093.

6. Applying that test requires identifying what the relevant supply is and who the supplier is.[3] To do that, it is necessary to examine the contract between the parties.[4] It is important to determine the legal obligations of the parties and what they have agreed on.[5]
7. The Act therefore is contractually based and is concerned with determining the legal arrangements between the parties. The particular transaction in question must be carefully considered in order to determine the legal character of that transaction.
8. Here, the contractual agreement for the supply of the relevant services is between the airport operators and the international airline operators. In exchange for payment from the international airline operators for the relevant services, the airport operators agree to provide the relevant services.
9. The provision of flights is a different contractual arrangement between the international airline operators and their customers (passengers or owners of transported cargo). Under this separate arrangement, international airline operators contract to fly passengers or goods for which their customers pay consideration by way of a fee. Although international airline operators can pass all or some of the costs for the services from airport operators on to their customers, this does not affect the fact that there is a separate contract.

The supply of services is chargeable with tax under s 8

10. A registered person charges GST of 15% on the supply of goods and services in New Zealand in the course or furtherance of a taxable activity carried on by them, by reference to the value of that supply, unless the supply is an exempt supply (s 8). However, they charge GST at the rate of 0% if zero-rating provisions apply.
11. The relevant supply is from the airport operators to international airline operators and both parties are GST registered. Airport operators provide the relevant services in the course or furtherance of their taxable activity, which includes the provision of such services.
12. The supply of the relevant services is not an exempt supply under the GST Act. Therefore, the supply of the relevant services is chargeable with tax under s 8. Whether GST is charged at 15% (standard-rated) or at 0% (zero-rated) depends on whether the last requirement of s 11A(1)(a) is satisfied.

The services are the transport of passengers or goods and not ancillary transport activities

13. The relevant services zero-rated under s 11A(1)(a) are the transport of passengers or goods from one place to another, where at least one place is outside New Zealand. This means that only the transport of passengers or goods is zero-rated, not other services.
14. The relevant services will not be zero-rated if they are ancillary transport activities. Ancillary transport activities, such as loading, unloading and handling, are standard-rated. The PIB concluded that the relevant services were standard-rated because they were "ancillary transport activities".
15. Section 11A(1)(a) has undergone changes since the GST Act was enacted in 1985. At first, services had to be "directly in connection with transportation … of passengers or goods" to be zero-rated. In 1988, the wording was intentionally narrowed to require the zero-rated services to "comprise the transport of passengers or goods". From 2000, the wording in s 11A(1)(a) is that the services "are the transport of passengers or goods".
16. The Commissioner considers that the change from "comprise the transport" to "are the transport" does not change the meaning of the provision. The words "comprise" and "are" are essentially synonyms.[6]

Transport

17. The *Concise Oxford English Dictionary* relevantly defines the term "transport" as "a system or means of transporting".
18. In addition to *Case P78* and *Auckland Regional Authority* considered below, court decisions have looked at what constitutes the transport of passengers or goods.[7] They have concluded that the essence of transport is the carriage of a passenger or

[3] *CIR v Databank Systems Ltd* (1990) 12 NZTC 7,227 (PC) at 7,321-7,235.

[4] *Wilson & Horton Ltd v CIR* (1995) 17 NZTC 12,325 (CA) at 328.

[5] *British Railways Board v Customs and Excise Commissioners* [1977] STC 221 (AC); *CIR v Bayly* (1998) 18 NZTC 14,073 (CA); *Television New Zealand Ltd v CIR* (1994) 16 NZTC 11,295 (HC).

[6] *Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York, 2011) defines "comprise" to include "consist of, be made up of; contain", and "are" to include "(when connecting a subject and complement) having a specified state, nature, or role".

[7] *Case P78* (1992) 14 NZTC 4,523; *Auckland Regional Authority v CIR* (1994) 16 NZTC 11,080 (HC).

goods from one point to another.[8] The word "transport" has a wider meaning than a seat on an airliner and can include in-flight catering.[9]

Ancillary

19. The *Concise Oxford English Dictionary* defines "ancillary", which appears in the phrase "ancillary transport activity", as "providing support to the primary activities of an organisation", "additional but less important" and "subsidiary".
20. A number of court cases have considered the meaning of the word "ancillary". They show that the meaning can be broad and the answer to the question of whether one activity is ancillary to another depends on the context.[10]
21. In *Smith's Snackfood Company*, the court concluded the meaning of "ancillary" is "auxiliary", "accessory", "subordinate" or "providing central support to the functioning of a central service". These interpretations are consistent with:
    - dictionary definitions of "ancillary";
    - *Green v Britten* ("subsidiary, subordinate or appurtenant to");[11] and
    - *Minagall v Ingram*[12] (where a relationship was required between the principal matter and an ancillary matter).
22. However, in some cases an ancillary activity may not be subservient to another (*Smith's Snackfood Company*).

Case P78

23. The court in *Case P78* considered the earlier versions of s 11A(1)(a). Judge Barber held that landing, aircraft parking, meteorological, control tower and safety services that an airport operator supplied to international airline operators were "directly in connection with transportation" and, therefore, zero-rated. This was because they were an integral part of transportation.[13]
24. Judge Barber considered that the services under consideration were not "ancillary transport activities" because they were not in a similar category to loading, unloading and handling. He considered that "ancillary" in this case meant subservient or subordinate to the provision of transport.[14]
25. Judge Barber also held that the services under consideration "comprise the transport" of passengers or goods and were not ancillary transport activities. This was because without the facility to land and take off, the air service could not occur. He said in passing that terminal services would have "comprised" transportation too.[15]
26. Judge Barber did note that the phrase "comprise the transport" is narrower than "directly in connection with transportation". However, the Commissioner considers that Judge Barber essentially applied the broader "directly in connection with" analysis in coming to the conclusion that the services under consideration "comprise" the transport of passengers or goods.[16]
27. Judge Barber concluded that rubbish disposal did not "comprise" transportation because it was not part of the carrying process and transportation activity.[17]

Auckland Regional Authority

28. In the High Court decision in *Auckland Regional Authority,* Barker J said that the phrase "comprise the transport" in an earlier version of s 11A(1)(a) seems to confer zero-rating only on services that "actually comprise" the transport of passengers or goods. Barker J did not need to decide the point because he was considering the earlier phrase "directly in connection with transportation" on similar facts to *Case P78*.[18]

[8] *Commissioners of Customs and Excise v Blackpool Pleasure Beach Co* [1974] 1 All ER 1011 (QB); *Quarry Tours Ltd v The Commissioners* [1984] 12 VATTR 238.

[9] *British Airways v Customs & Excise Commissioners* [1990] BTC 5,124 (AC). The court decision cited this case with approval in *Auckland Regional Authority*.

[10] *New South Wales Crime Commission v Ollis* [2006] NSWCA 76, 161 A Crim R 97; *Smith's Snackfood Company Ltd v Chief Commissioner of State Revenue* [2013] NSWCA 470, (2013) 97 ATR 904.

[11] *Green v Britten* [1904] 1 KB 350 (AC).

[12] *Minagall v Ingram* [1968] SASR 237 (SASC).

[13] *Case P78* at 4,531–4,532.

[14] *Case P78* at 4,532.

[15] *Case P78* at 4,532.

[16] *Case P78* at 4,532.

[17] *Case P78* at 4,533.

[18] *Auckland Regional Authority* at 11,083.

29. However, Barker J's comment may have been referring to the acknowledgement in *Case P78* that the carriers or airlines provide "the actual transport of goods and passengers".[19] His comment is also consistent with the conclusion in *Case P78* that rubbish disposal is not part of the carrying process.
30. Barker J considered the meaning of "ancillary transport activity". Contrary to *Case P78*, he concluded that international terminal services[20] were ancillary because they were "secondary or subservient" and were "of the same kind of transport activity as loading, unloading and handling".[21]
31. However, Barker J agreed with *Case P78* that landing and departing were not ancillary transport activities (although this was in the context of considering the "directly in connection with transportation" phrase). He also agreed that rubbish disposal was provided as a separate service but considered that it was, alternatively, an "ancillary transport activity".

Conclusion on s 11A(1)(a)

32. The Commissioner considers that none of the relevant services considered in this QWBA (garbage disposal, lighting and security, aircraft parking and terminal services) is the transport of passengers or goods for the purposes of s 11A(1)(a). This is because the relevant services do not involve the carriage of a passenger or goods from one point to another. Therefore, the Commissioner considers that the relevant services are not zero-rated under s 11A(1)(a).
33. The PIB concluded that the relevant services were standard-rated but for a different reason. The PIB considered the relevant services to be "ancillary transport activities". It is not strictly necessary to reach a conclusion on this point because it is already concluded here that the relevant services are standard-rated. However, the Commissioner considers that the relevant services are, alternatively, ancillary transport activities that are not zero-rated under s 11A(1)(a). This is because the relevant services relate to the provision of essential support to a central service. The relevant services support the supply of transport by international airline operators.

When services can be zero-rated under s 11A(1)(h) and(i)

34. Services are zero-rated under other paragraphs of s 11A(1). These include services that are supplied directly in connection with:
    - goods in transit through New Zealand, including stores for aircrafts, provided the goods are not removed from the aircraft while in New Zealand (s 11A(1)(h)); and
    - temporarily imported goods (s 11A(1)(i)).
35. The Commissioner considers that the relevant services are not "directly in connection" with goods in transit or temporarily imported. The relevant services are services that airport operators provide to international airline operators. These are not services supplied directly in connection with the goods themselves such as loading, unloading and handling.[22] Therefore, there is no clear and direct relationship between the relevant services and the goods.
36. Further, although a private aircraft can be a temporarily imported good, the Commissioner considers that temporary imports do not include commercial aircraft with goods and passengers that arrive in and depart from New Zealand.
37. The Commissioner therefore considers that s 11A(1)(h) and (i) also does not apply to zero-rate the relevant services. On this basis, the relevant services are subject to GST at the standard-rate of 15%.

[19] *Case P78* at 4,532.

[20] The terminal services included the use of air bridges, maintenance and cleaning of carousels, gate lounges, storage and distribution areas, and removal of sewage tanks.

[21] *Auckland Regional Authority* at 11,085.

[22] *Wilson & Horton Ltd v CIR* (1994) 16 NZTC 11,221 (HC) at 11,224.

References

Legislative references

Goods and Services Tax Act 1985, ss 8, 11A(1)(a), (h) and (i)

Case references

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British Airways v Customs & Excise Commissioners [1990] BTC 5,124 (AC)

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Case P78 (1992) 14 NZTC 4,523

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CIR v Databank Systems Ltd (1990) 12 NZTC 7,227 (PC)

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Databank Systems Ltd v CIR (1989) 11 NZTC 6,093 (CA)

Green v Britten [1904] 1 KB 350 (AC)

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New South Wales Crime Commission v Ollis [2006] NSWCA 76, 161 A Crim R 97

Quarry Tours Ltd v The Commissioners [1984] 12 VATTR 238

Smith's Snackfood Company Ltd v Chief Commissioner of State Revenue [2013] NSWCA 470, (2013) 97 ATR 904

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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 22/08: Quantum of suppressed income and whether it is dividend or employment income

Technical decision summary: Adjudication

Decision date | Te Rā o te Whakatau: 22 December 2021

Issue date | Te Rā Tuku: 15 June 2022

Subjects | Ngā kaupapa

Quantum of suppressed income; Nature of income, employment or dividend; Treatment of reparation order payments

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

CCS	Customer and Compliance Services, Inland Revenue
Commissioner	Commissioner of Inland Revenue
GST	Goods and services tax
TRA	Taxation Review Authority
SOP	Statement of Position
TCO	Tax Counsel Office, Inland Revenue

Taxation laws | Ngā ture take

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

Facts | Ngā meka

1. This TDS relates to two separate Adjudication decisions for two taxpayers (**Taxpayers**) who were co-directors and 50/50 shareholders in a company. Because the facts, decisions, and reasons for the two decisions were the same for both taxpayers, except in respect of a matter relating to a reparation order, the two decisions have been combined into one technical decision summary. The issue relating to the reparation order that only relates to one taxpayer is dealt with in issue 3 in the technical decision summary.
2. The Taxpayers, who are individuals, were both directors in the Company which operated three retail establishments. The Taxpayers worked in the businesses.
3. Customer and Compliance Services (**CCS**), Inland Revenue conducted a risk review which led to an audit of the Taxpayers and the Company including searches of the business premises and the seizure of business records. Several voluntary disclosures of omitted income were made on the Company's behalf during this process.

4. The Commissioner formed the view that the Company had been involved in fraudulent activity by suppressing cash sales and under returning GST and income tax. The Commissioner also formed the view that the Taxpayers had been involved in fraudulent activity by suppressing dividend income received from the Company and under returning income tax. Amended assessments were issued accordingly for the Company and for each of the Taxpayers.
5. The Commissioner laid criminal charges against one of the Taxpayers and following a jury trial they were convicted, and a reparation order was made as part of the sentence.
6. The Taxpayers each issued a Notice of Proposed Adjustment to commence the disputes process. In their individual Statements of Position (**SOP**), the Taxpayers rejected the Commissioner's assessments as arbitrary and demonstrably unfair. The Taxpayers also argued the assessments should be cancelled as they incorrectly assessed the omitted income as dividend income rather than employment income. The Taxpayer concerned also submitted that payment of the reparation order should be deducted from the Taxpayer's core tax liability.
7. The Commissioner in her SOP rejected the Taxpayers' positions, arguing that the Taxpayers had not proved that the Commissioner's assessments were wrong and by how much they were wrong. The Commissioner maintained that the omitted income derived by the Taxpayers from the Company was dividend income.
8. The matter was referred to the Tax Counsel Office (**TCO**), Inland Revenue for adjudication.

Issues | Ngā take

9. The main issues considered in this dispute were:
    - Whether the quantum of the Commissioner's assessments was wrong. This involves two subsidiary issues of:
        - Whether the assessments were arbitrary or demonstrably unfair.
        - Whether the Taxpayers had proved the Commissioner's assessments were wrong.
    - Whether the additional income derived from the Company in the disputed periods was employment or dividend income.
10. Another matter that arose was how the Court ordered reparation should be dealt with.

Decisions | Ngā whakatau

11. TCO decided that:
    - The Taxpayers have not shown that the quantum of the Commissioner's assessments was wrong.
    - The Taxpayers have not shown the additional income they received from the Company was employment income and not a deemed dividend.
12. In relation to the reparation order made by the Court, CCS has stated that if the Taxpayer pays the reparation payment, the Commissioner will credit the payment to the Taxpayer's core tax liability.

Reasons for decisions | Ngā take mō ngā whakatau

Issue 1 | Take tuatahi: Quantum of income

13. The Taxpayers argued the methodology used by the Commissioner to calculate the Company's omitted income (and as a consequence of that, the Taxpayers' omitted income) had limitations and uncertainties which meant that the Taxpayers' assessments were arbitrary and unfair. The Taxpayers also argued that the Commissioner's assets accretion analysis had failed to identify assets or expenditure matching the alleged omitted income. The Taxpayer asserted that calculations done by a forensic accountant they engaged properly represented the amount of omitted income for the Company.
14. CCS argued the Commissioner's basis for calculating the assessments was fair and produced the most accurate assessment of the Taxpayers' income. CCS argued that the approach taken by the forensic accountant was inaccurate as it ignored evidence of cash sales found by the Commissioner in her search of the business premises.
15. To address these arguments, TCO considered the following points:
    - who must prove a matter (the onus of proof);
    - to what standard the person must prove the matter (the standard of proof);
    - the basis on which the assessments are made (the threshold onus);
    - credibility.

Onus of proof

16. 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]

Standard of proof

17. 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 probable than not.

Threshold onus

18. From an examination of the relevant case law[5], the following principles may be derived in relation to the Commissioner issuing an assessment:
    - An assessment cannot be arbitrary.
    - The Commissioner must have some information on which to base an assessment.
    - The Commissioner may base an assessment on the information in the Commissioner's possession and need not seek further information from other sources.
    - The Commissioner cannot act in disregard of the law or facts known to her.
    - There is no overriding duty on the Commissioner to fully resolve the taxpayer's affairs before assessing.
    - An assessment remains valid even if the Commissioner believes further enquiries may be required to arrive at the correct tax payable.
    - The Commissioner may properly make an assessment which the Commissioner believes is not necessarily correct, or even probably wrong to some extent. This is so long as the Commissioner believes the assessment to be the best the Commissioner can do until further information is obtained.
    - Precision or mathematical certainty may be unattainable.
    - The Commissioner must make an honest judgment as to what the correct figure should be on the information available to the Commissioner.

Credibility

19. TCO adjudicates disputes solely on the documentary evidence provided by the parties to the dispute. It does not see or hear taxpayers give evidence and so is not able to assess their credibility first hand.
20. Sometimes CCS assesses credibility based on its dealings with the taxpayer. When adjudicating a dispute, TCO will consider any assessment made by CCS as to a taxpayer's credibility. All the parties' arguments and the available evidence will also be considered.
21. A taxpayer will have the opportunity in any later challenge proceedings to have their credibility assessed by the TRA or a court.

Application to the facts

22. TCO considered the arguments presented by the Taxpayer and CCS and answered two related issues:
    - Were the Commissioner's assessments arbitrary or demonstrably unfair?
    - If not, did the Taxpayers prove that the assessments were wrong, why they were wrong and by how much they were wrong?

[1] Challenge proceedings (i.e., the proceedings that would follow if this dispute proceeds to the Taxation Review Authority 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] See *Lowe v CIR* (1981) 5 NZTC 61,006 (CA); *CIR v Canterbury Frozen Meat Co Ltd* (1994) 16 NZTC 11,150 (CA); *Golden Bay Cement Co Ltd v CIR* (No 1) (1995) 17 NZTC 12,253 (HC), a decision confirmed by the Court of Appeal: *Golden Bay Cement Company Ltd v CIR* (1996) 17 NZTC 12,580 (CA); *CIR v Dandelion Investments Ltd* (2001) 20 NZTC 17,293 (HC); *Dandelion Investments Ltd v CIR* (2003) 21 NZTC 18,010 (CA).

Were the Commissioner's assessments arbitrary or demonstrably unfair?

23. The Commissioner relied on the evidence of cash sales found at the business premises to calculate the income omitted by the Company and made available to the Taxpayers. She was able to verify information and also make reasonable inferences. Cash sales percentages and gross profit margins calculated by the Commissioner were then compared with data from similar businesses and found to be consistent.

    TCO concluded the methodology adopted by CCS involved the exercise of judgment and consideration of relevant facts and information. The Commissioner made the best assessments possible on the available evidence. The assessments were not arbitrary or demonstrably unfair.

Did the Taxpayers prove the assessments were wrong?

24. The Taxpayers asserted that the assessments made by the Commissioner were wrong and the correct amount of omitted income was submitted in the Taxpayers' voluntary disclosures as adjusted by the forensic accountant they engaged.
25. TCO concluded that the approach taken by the forensic accountant ignored the only direct evidence of sales for the disputed periods and used a cashflow and assets accretion analysis that assumed all the money received from the Company was spent on assets retained by the Taxpayers. On this basis, the accountant concluded that a lesser sum had been received from the Company by the Taxpayers. While there was evidence that the Taxpayers used some of the undisclosed cash to acquire assets such as an overseas rental property, it was also noted that the Taxpayers travelled regularly overseas. If the Taxpayers had physically taken New Zealand currency to an overseas destination or spent the cash on consumables such as travel or other living expenses, the accountant's methodology would not capture those amounts.
26. The Commissioner must determine as best she can on the information available the amount on which tax is payable and what is the amount of that tax. TCO considered that she had done so with the assessments which were based on the available evidence. The Taxpayers had not shown that the calculations of the forensic accountant should be preferred to the approach followed by the Commissioner.

Issue 2 | Take tuarua: Nature of income

27. The issue is whether the additional income derived by the Taxpayers from the Company in the tax years in dispute was dividend or employment income.
28. The Taxpayers argued the income derived from the Company was taken in the form of drawings in their capacity as employees and was properly regarded as salary and wages, not dividend income. This was on the basis the Taxpayers worked in the business 24/7 operating the three establishments and had historically received regular monthly drawings and/or a shareholder salary. The Taxpayers argued that to treat the income as unimputed dividend income was unlawful as it denied the Company a deduction for the expense of remunerating the Taxpayers and effectively amounted to double taxation. The Taxpayers argued the assessments were not made on an intelligible basis and should be cancelled as incorrectly assessing the omitted income as dividend rather than employment income.
29. CCS argued that the Taxpayers had already received shareholder salaries for their services. The significant amounts of cash transferred to the Taxpayers in addition to that salary were not for any services provided but were a transfer of value caused by a shareholding relationship and, therefore, a dividend.

Employment income

30. Section CE 1 states that certain amounts derived by a taxpayer in connection with their employment or service are income of that taxpayer. Some key principles from the analysis on employment income are:
    - Employment income includes salary, wages, or allowances relating to the employment of a person (s CE 1(1)(a)).
    - Employment income includes "expenditure on account of an employee", which is where an employer pays for expenditure that is incurred by the employee or is to be incurred (s CE 1(1)(b)).
    - Employment income includes "any other benefit in money" in connection with their employment or service. This is intended to be a catch-all with broad application (s CE 1(1)(g)).

Dividend income

31. Section CD 1 provides that a dividend derived by a person is income of that person. Section CD 3 states that ss CD 4 to CD 21 define what a dividend is. Some general principles can be drawn from analysis of the legislation and case law:
    - A dividend derived by a person is income to them (s CD 1).
    - A dividend is a transfer of company value from a company to a person caused by a shareholding in that company (ss CD 4(1) and CD 6). A transfer of company value occurs where a company provides money or money's worth to a person where the market value of this is more than the market value of money or money's worth the person provides (s CD 5(1)).
    - One indication that a transfer of company value is caused by a shareholding relationship is if the terms of the arrangement that results in the transfer are different from the terms for a similar arrangement where no shareholding is involved (s CD 6(2)).
    - Dividends under tax law do not have to reflect the character of dividends as generally understood. There is nothing in the ITA 2007 stating that dividends must be paid out of company profits. Where companies incur expenditure for the benefit of a shareholder there may be a dividend under tax law to that shareholder.[6]
    - Drawings (that is, payments made by a company to a shareholder in reduction of the shareholder's current account with the company) are not regarded as income of the shareholder but as non-assessable loan repayments.
    - For a payment to a shareholder to be drawings there must be some evidence to show that the company was aware of, and acquiesced in, the making of the payment as a reduction in the shareholder's current account.[7]
    - In the absence of contemporaneous evidence, such as book entries showing debits to a shareholder's current account with a company, it may be difficult for a person to show that the receipts are non-assessable drawings.[8]

Application to the facts

32. TCO considered the parties' arguments about whether the additional income derived by the Taxpayers from the Company in the disputed periods was employment or dividend income of the Taxpayers. The Taxpayers' view was that the additional income was employment income. The Commissioner maintained her view that the additional income was a deemed dividend.
33. The additional income will be a dividend under s CD 4(1) if:
    - there is a transfer of company value from a company to a person; and
    - the cause of the transfer is a shareholding in the company.
34. TCO considered whether the income was employment income as part of its discussion of the cause of the transfer of value to the Taxpayers.

Was there a transfer of company value?

35. TCO concluded that there had been a transfer of value from the Company to the Taxpayers. The Taxpayers voluntarily disclosed that cash from the sales income of the Company's businesses was deposited into the personal bank accounts of the Taxpayers and was not returned as income by either the Company or the Taxpayers. The Commissioner's audit found evidence that cash sourced from the businesses and not deposited into bank accounts was provided to the Taxpayers.

Was the transfer of value due to the Taxpayers' shareholding?

36. CCS argued the only reason the cash amounts were paid to the Taxpayers was because of the shareholding relationship and that the amounts were dividend income. The Taxpayers argued that the amounts were employment income and not dividend income.
37. TCO found that the Taxpayers did not provide any documentary evidence to support their view that the omitted income should properly be regarded as salary and wages (e.g. shareholder current accounts or evidence such as a board resolution to pay additional salary). Although the Company allocated a modest shareholder salary to the Taxpayers each year, without further evidence this does not necessarily mean that the nature of substantially larger amounts provided to the Taxpayers would also be treated as employment income. No documentation was provided to suggest the Company intended to treat

[6] *McIlraith v CIR* (2007) 23 NZTC 21,456 (HC) at [29].

[7] *Case Q6* (1993) 15 NZTC 5047 at 5,049, 5,050 and 5,051.

[8] *Case 12/2015* [2015] NZTRA 12, (2015) 27 NZTC 3,011 at [57]-[58].

the omitted income as drawings and convert it to a shareholder salary. On the contrary the income was suppressed by the Company and omitted from the Taxpayers' income tax returns which suggests there was no intention at the time to treat it as drawings and shareholder salary.

38. Since the Taxpayers have not proved the omitted income is employment income then the only reason for the Company to have made transfers of value was because of the Taxpayers' shareholding in the Company. On this basis the omitted income is a dividend.

39. This outcome is supported by s CD 6(2) which provides that an indicator that a transfer of value is caused by a shareholding relationship is if the terms of the arrangement that result in the transfer are different from the terms for a similar arrangement where no shareholding is involved.

40. The Taxpayers argued that any employed manager of such an operation would have received a regular salary just as the Taxpayers did and it was not a transfer of value due to a shareholding but a regular payment for the personal exertion of the employees.

41. The Taxpayers did not provide any evidence of a documented regular salary for themselves therefore it was assumed that by a regular salary the Taxpayers meant the cash that was taken from the till on a regular basis. It is considered unlikely that a person employed by the Company as a manager of the establishments (and not a shareholder) would receive their salary by taking regular amounts from the till without documentation or oversight. It also seems unlikely that the Company would pay that person such a substantial amount if they were not a shareholder.

42. For those reasons TCO considered the Company allowed the Taxpayers to take regular income from the till without documentation or oversight because of their shareholding in the Company rather than because of the services they performed. This indicated that the transfer of value was caused by a shareholding relationship and that the omitted income is a deemed dividend.

43. Although the imputation credit account regime, in general terms, seeks to avoid double taxation between a company and its shareholders, double taxation does occur in some circumstances, including the circumstances of the Company and the Taxpayers where it has been concluded that the amount is a dividend. Further, the Company has been removed from the Companies Register and CCS notes that it is unlikely that it has the means to pay its tax liability.

Issue 3 | Take tuatoru: Application of the reparation order

44. The Commissioner laid criminal charges against one of the Taxpayers and following a jury trial they were convicted, and a reparation order was made as part of the sentence. The treatment of the reparation payment was raised.

45. TCO considered the Court of Appeal case *R v Allan* and in particular the statement in the decision that reparation is not a tax collecting mechanism. [9] From this it concluded that it is not clear that reparation payments are tax payments. TCO made the observation that unlike the normal situation where an assessment is issued by the Commissioner and there is a liability to pay the tax, where a reparation order is made, the offender is to pay the reparation to the Ministry of Justice. The Ministry of Justice must then pay this money to the person who is the recipient under the reparation order.

46. Regardless of this, CCS stated that if the Taxpayer in question pays the reparation payment, the Commissioner would credit the payment to the Taxpayer's core tax liability.

47. Given that no payment of reparation has been made, the existence of an order to make payment cannot be taken into account to reduce the Taxpayer's income tax liability.

[9] *R v Allan* [2009] NZCA 439, (2009) 24 NZTC 23,815.

TDS 22/09: GST: Private recreational pursuit or hobby, taxable activity

Technical decision summary: Adjudication

Decision date | Te Rā o te Whakatau: 11 November 2021

Issue date | Te Rā Tuku: 15 June 2022

Subjects | Ngā kaupapa

GST: Private recreational pursuit or hobby, taxable activity

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

Commissioner	Commissioner of Inland Revenue
GST	Goods and services tax
GST Act	Goods and Services Tax Act 1985
CCS	Customer & Compliance Services of Inland Revenue
TAA	Tax Administration Act 1994

Taxation laws | Ngā ture tāke

All legislative references are to the Goods and Services Tax Act 1985 (GST Act) unless otherwise stated.

Facts | Ngā meka

1. The Taxpayer is a horse racing syndicate formed by a company that breeds, agists, and sells racehorses (Company). The Taxpayer was formed by the director of the Company (not by the individual members).
2. The agreement constituting the Taxpayer (Agreement) sets out the names of the Taxpayer's members and their shareholdings. The Taxpayer's shares were held in various proportions by a number of natural persons and the Company.
3. The Agreement does not state the purpose for which the Taxpayer was formed. However, the Taxpayer argued that it was formed with an intent to be successful so that the members would become long term participants in the racing industry. The Taxpayer also argued:
    - The intent of the Company was that a profit would be made from the Taxpayer's activity.
    - In line with their marketing and breeding policies, as well as to share costs of improving the value of its horses, the Company leased horses to syndicates (managed by itself) for up to 3 years.
    - The syndicates looked after the racing of the horses until they were ready to breed.
4. The Agreement sets out the Taxpayer's rules. In particular, the rules name the director of the Company as the Taxpayer's manager (Manager).
5. The Taxpayer leased the horses. Among other things, the leases provide that:
    - The Taxpayer had no right to purchase any of the horses.
    - The lessor would not charge any percentage of the stakes earned by a horse.
    - The lessee could terminate the lease at any time after giving one month's notice.
    - At the end of each lease, the horses were to be delivered back to the lessor.
6. Several of the horses had varying racing success resulting in stakes income. The other horses did not generate any stakes income. All the horses were withdrawn from the Taxpayer's racing activity before the end of the lease terms. The horses were not replaced as they were withdrawn and the Taxpayer's racing activities ceased shortly after the last horse was withdrawn.

7. The Taxpayer was registered for GST purposes. The Taxpayer returned outputs (sales) and inputs (expenses) in its GST returns. The inputs consistently exceeded the outputs. Accordingly, all the Taxpayer's returns showed GST refunds.

Issues | Ngā take

8. The main issue in dispute is whether the Taxpayer was carrying on a taxable activity.
9. There was also a preliminary issue on the onus and standard of proof.

Decisions | Ngā whakatau

10. The Tax Counsel Office decided that:
    - The Taxpayer was not carrying on a taxable activity.
    - The Taxpayer carried on its activity as a private recreational pursuit or hobby.

Reasons for decisions | Ngā take mō ngā whakatau

Preliminary issue | Take tōmua: Onus and standard of proof

11. 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]
12. 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 probable than not. Whether the Taxpayer has discharged the onus of proof is considered in the relevant issues.

Issue | Take: Taxable activity

13. GST is imposed on taxable supplies. These are supplies of goods and services in New Zealand made by a registered person in the course or furtherance of a taxable activity carried on by the registered person.[5] To be GST registered and subject to the Goods and Services Act 1985 (GST Act) a person must be carrying on a taxable activity. A taxable activity does not include an activity carried on essentially as a private recreational pursuit or hobby.
14. A taxable activity is an activity:
    - carried on continuously or regularly by a person
    - whether or not for a pecuniary profit
    - that involves, or is intended to involve, the supply of goods and services to another person for consideration.[6]
15. It is noted that s 5(11CB) of the GST Act:
    - provides that a prize received from a racing club by a registered person in the course of a taxable activity for the performance in a race of a horse is treated as consideration for a service supplied to the racing club, but
    - does not cause or deem a horse racing activity carried on by a person to become a taxable activity.[7]
16. An activity will not be a taxable activity if it is carried on essentially as a private recreational pursuit or hobby.[8]

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

[2] Section 149A(2) of the Tax Administration Act 1994 (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] Section 8(1) and the definition of "taxable supply" in s 2(1) of the GST Act.

[6] Section 6(1)(a) of the GST Act.

[7] See commentary on the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Bill at 94.

[8] Section 6(3)(aa).

17. To be carried on "essentially as a private recreational pursuit or hobby", an activity must be in essence of such a nature. In *Case N27*, Judge Bathgate said:[9]

> The word "essentially" in the phrase mentioned, I think emphasises the necessity for the activity being clearly a private recreational pursuit or hobby. …
>
> For an activity to be carried on essentially, as a private recreational pursuit or hobby, that activity must be in essence of such a nature, in the context of sec 6, so that although an activity may have some of the appearances or some of the attributes of such an activity, it will not be exempt from the definition of "taxable activity" unless it is in essence a private recreational pursuit or hobby. An activity that might also seem to be a business would not, to my mind, be one that was "carried on essentially as a private recreational pursuit or hobby".

18. CCS did not dispute that the Taxpayer's activity met the taxable activity requirements in s 6(1)(a). However, CCS argued that the activity was not a taxable activity because, if carried on by a natural person, the activity would be carried on essentially as a private recreational pursuit or hobby (s 6(3)(aa)).
19. The Tax Counsel Office considered the case law referred to by the parties and provided the following summary of principles:
    - An activity carried on essentially as a private recreational pursuit or hobby is a private pastime or pursuit carried on for the personal refreshment, pleasure or recreation of the person or persons concerned.[10]
    - An activity that is organised in a coherent fashion to achieve a profit will not be a private recreational pursuit or hobby.[11]
    - An activity coherently organised for the purpose of making a profit will not necessarily be a private recreational pursuit or hobby if those involved derive private and personal enjoyment from the activity.[12]
    - An activity that is a vocation or the source of the taxpayer's livelihood is unlikely to be carried on essentially as a private recreational pursuit or hobby.[13]
    - Given the significant element of chance in relation to winning prize money from the racing of horses there must be a sufficient system in relation to the chances involved to show that a profit-making system has been devised.[14]
    - The use of skill involved in training a horse is not decisive of whether a business is carried on and may not be relevant in many cases.[15]
    - Whether an activity is a private recreational pursuit or hobby is a question of fact and depends on the totality of the evidence.[16]
    - The focus is on the activity and how it is organised and carried on.[17]
    - It is the collective purpose of an unincorporated body carrying on an activity that is relevant in determining the purpose for the activity carried on.[18]
    - It is the dominant purpose of the taxpayer that is relevant in determining whether their activity is a private recreational pursuit or hobby.[19]

[9] *Case N27* (1991) 13 NZTC 3,229 at 3,240.

[10] *Case N27*, *Case L24* (1989) 11 NZTC 1,154, *Shepherd v FCT* 75 ATC 4,244 (SC), *Martin v FCT* (1953) 10 ATD 226 (HCA), *Graham v Green* [1925] All ER 690 (KBD).

[11] *Case L24*, *Shepherd v FCT*, *Graham v Green*, *Martin v FCT*.

[12] *Case N27*, *Case M131* (1990) 12 NZTC 2,850.

[13] *Shepherd v FCT*, *Graham v Green*, *Case K40* (1988) 10 NZTC 343.

[14] *Shepherd v FCT*.

[15] *Shepherd v FCT*, *Graham v Green*.

[16] *Case N27*.

[17] *Case N27*, *Case L24*.

[18] *Case N27*, *CIR v Boanas & Ors* (2008) 23 NZTC 22,046 (HC).

[19] *Case L24*, *Case P73* (1992) 14 NZTC 4,489, *Shepherd v FCT*.

20. Applying those principles to the facts in this case, the Tax Counsel Office concluded that the Taxpayer carried on its activity as a private recreational pursuit or hobby. This was because:

- The Taxpayer had not shown that it was formed for the purpose of making a profit from its horse racing activity and operated in that manner. The evidence provided suggested that:
  - the Taxpayer was formed for the personal interest or pleasure of its members
  - the way the Taxpayer was organised and operated emphasised the recreational aspect of the Taxpayer's activity
  - there was no clear indication of the purpose for which the Taxpayer was formed.

  In addition, it would be inappropriate to attribute the Company's purposes to the Taxpayer's members.
- The Taxpayer had not shown that its activity was organised to achieve a pecuniary profit and operated in a systematic fashion that materially reduced the element that luck played in whether it won any prize money. The number of horses the Taxpayer leased and raced, the quality of the horses, and its use of top trainers may have been due to a system devised to reduce the element that luck played in winning prize money. However, the more likely reason was the Company's strategy to improve the quality of its horses by having more to breed from, have its horses looked after and raced until they were ready to breed from, and sharing the costs of improving the value of its horses. This was given other evidence suggesting that the Taxpayer was formed for the personal interest or pleasure of its members. The financial results of other horse racing syndicates established by the Company may show a possibility that the Taxpayer could have made a profit. However, the results also show that a significant amount of luck would have been involved. The results did not show there having been any material reduction in the element that luck played in the syndicates, including the Taxpayer, winning prize money.
- Given the number of horses the Taxpayer leased and raced and the number of members the Taxpayer had, the time involved in its management activities does not seem so significant or sufficient to show the Taxpayer's activity was carried on as a taxable activity rather than a private recreational pursuit or hobby. It might reasonably be expected that a similar amount of time would be involved whether the Taxpayer's activity was carried on as a taxable activity or private recreational pursuit or hobby. In addition, it seemed likely that some of the time was spent on behalf and for the benefit of the Company and not solely for the benefit of the Taxpayer.

TDS 22/10: GST – Whether property sale is zerorated. Time bar.

Technical decision summary: Adjudication

Decision date | Te Rā o te Whakatau: 24 November 2021

Issue date | Te Rā Tuku: 15 June 2022

Subjects | Ngā kaupapa

GST: Whether property sale was zero-rated. Whether proposed amendment to assessment was timebarred.

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

Agreement	Agreement for sale and purchase of the Property
CCS	Customer & Compliance Services, Inland Revenue
Commissioner	Commissioner of Inland Revenue
GST	Goods and services tax
GST Act	Goods and Services Tax Act 1985
Property	One of the properties in the Taxpayer's unit title subdivision
TAA	Tax Administration Act 1994

Taxation laws | Ngā ture tāke

All legislative references are to the Goods and Services Tax Act 1985 (GST Act) unless otherwise stated.

Facts | Ngā meka

1. The Taxpayer is a company and is registered for GST on the invoice basis. The Taxpayer's taxable activity involved building residential properties for sale and carrying out renovations.
2. The Taxpayer purchased vacant land. It constructed two dwellings on the land for disposal as part of its taxable activity. Before the dwellings were sold the land was divided by way of a unit title subdivision. The dispute relates to the sale of one of the resulting properties (**Property**).
3. The Taxpayer and the purchaser entered into an agreement for the sale and purchase of the Property (**Agreement**). The Property was untenanted and was to be sold with vacant possession. The purchase price was stated to be "inclusive of GST (if any)". The Agreement was in the form of the ninth edition 2012 (3) of the REINZ/ADLS standard form agreement. Clause 15 of the Agreement (the "going concern" clause) had not been deleted.
4. In the GST Schedule to the Agreement, the purchaser answered "yes" to the question about whether the purchaser is registered under the GST Act and/or will be so registered at settlement. However, the purchaser did not answer the questions about whether it intended to use the property at settlement:
    - for making taxable supplies, or
    - as a principal place of residence by the purchaser or a person associated with the purchaser under section 2A(1)(c) of the GST Act (connected by blood relationship, marriage, civil union, de factor relationship or adoption).
5. Two days in advance of settlement, the Taxpayer issued a settlement statement and tax invoice to the purchaser, both of which recorded the sale of the Property as a zerorated supply for GST purposes.
6. The Taxpayer and purchaser then settled the sale and purchase of the Property. As agreed the Property was vacant on settlement.

7. Several weeks later the Taxpayer's accountants emailed the purchaser's solicitors asking the purchaser to complete the GST Schedule to the Agreement, and to confirm whether the purchaser intended to use the Property for long-term or short-term accommodation.
8. The purchaser's solicitors responded with an amended GST Schedule signed by the purchaser. The Schedule confirmed that the purchaser was registered for GST at settlement. In addition, the purchaser now answered "yes" to the question about whether it intended at settlement to use the property for making taxable supplies and "no" to the question about whether it intended at settlement to use the property as a principal place of residence by the purchaser or a person associated with the purchaser. The purchaser did not comment on whether it intended to use the Property for long-term or short-term accommodation.
9. The Taxpayer treated the sale of the Property as a zero-rated supply in its GST return for the relevant period (GST disputed period).
10. The purchaser subsequently applied for holiday home registration for the Property. Holiday home registration entitles the owner to let the property for short-term accommodation for up to 90 nights per rating year. However the purchaser never held a visitor accommodation consent in respect of the Property.
11. Customer & Compliance Services, Inland Revenue (**CCS**) audited the Taxpayer and initiated a dispute. CCS proposed to amend the assessment for the Taxpayer's GST return for the GST disputed period to include output tax on the supply of the Property.
12. The relevant assessment was time barred under s 108A(1) of the Tax Administration Act 1994 (TAA), subject to whether the exception in s 108A(3) applied.

Issues | Ngā take

13. The main issues considered in this dispute were:
    - Was GST payable on the sale of the Property? This required consideration of the following sub-issues:
        - Whether the Taxpayer sold a going concern
        - Whether the sale was compulsorily zero-rated
    - Was the Commissioner entitled to amend the assessment for the Taxpayer's GST return for the GST disputed period?

Decisions | Ngā whakatau

14. The Tax Counsel Office reached the following decisions on the issues:
    - The supply made by the Taxpayer to the purchaser was not zero-rated either as the supply of a going concern or under the compulsory zero-rating provisions. The Taxpayer was therefore required to return output tax on the supply.
    - However, CCS's position that the time bar exception in s 108A(3) of the TAA applied was not accepted. The proposed amendment to the assessment was time-barred.

Reasons for decisions | Ngā take mō ngā whakatau

Issue 1 | Take tuatahi: What is the onus and standard of proof?

15. The issue was who must prove a matter (the onus of proof) and to what standard the person must prove the matter (the standard of proof).
16. CCS argued the onus of proof was on the taxpayer to show the sale was zero-rated and that the Taxpayer had not provided sufficient evidence to support its position that the sale of the Property was zero-rated. The Taxpayer did not dispute that the onus of proof was on it to show the sale was zero-rated, but argued that it had provided sufficient evidence to support its position that the sale of the Property was zero-rated.
17. The Taxpayer disputed whether the onus of proof was on it to show that the Commissioner honestly held the opinion that the Taxpayer knowingly or fraudulently failed to provide to the Commissioner all material facts necessary for determining the amount of GST payable for the GST disputed period. The Taxpayer argued there was a threshold onus on the Commissioner. CCS argued that as the Commissioner had formed an opinion, the onus was on the Taxpayer to show:
    - the Commissioner did not honestly hold the opinion, or
    - the opinion was not open to the Commissioner on the available facts.

18. The onus of proof in civil proceedings is on the taxpayer,[1] 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]
19. 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 probable than not.
20. However, in some cases a taxpayer may be able to discharge the onus of proof by showing that the assessment is arbitrary or demonstrably unfair.[5]
21. Whether the Taxpayer had discharged the onus of proof is considered in the following issues.

Issue 2 | Take tuarua: Is GST payable on the sale of the Property?

22. The issue was whether GST was payable on the sale of the Property. This depended on whether:
    - the Taxpayer sold a going concern under s 11(1)(m); or
    - the Taxpayer had shown the sale was compulsorily zero-rated under s 11(1)(mb).

Going concern

23. CCS argued that the sale was not of a going concern under s 11(1)(m) because:
    - The goods transferred did not amount to a going concern as the Taxpayer did not sell all or a part of its taxable activity – it simply sold an asset.
    - The parties had not agreed in writing that the sale was a supply of a going concern (s 11(1)(m)(i)).
    - The parties did not "intend" (at the time of supply) that the sale of the Property was to be a supply of part of a taxable activity capable of being carried on as a going concern by the recipient (s 11(1)(m)(ii)).
24. The Taxpayer argued that it sold a going concern under s 11(1)(m) because:
    - The Taxpayer sold a part of its taxable activity that was capable of separate operation. Part of the Taxpayer's taxable activity was selling property. The sale of the Property was, therefore, a sale of a part of the Taxpayer's taxable activity, as the Taxpayer supplied everything the purchaser needed to carry on a taxable activity of selling property. The purchaser did in fact sell the Property, within a relatively short time.
    - The parties had recorded that the sale was of a going concern in clause 15 of the Agreement.
    - The parties intended the sale was to be of a going concern – if the parties had not intended the sale to be of a going concern, they would have deleted clause 15.
25. The zero-rating of the supply of going concerns is provided for by s 11(1)(m). Section 11(1)(m) states:

> **11 Zero-rating of goods**
>
> (1) A supply of goods that is chargeable with tax under section 8 must be charged at the rate of 0% in the following situations:
>
> …
>
> (m) the supply to a registered person of a taxable activity, or part of a taxable activity, that is a going concern at the time of the supply, if –
>
> (i) the supplier and the recipient agree that the supply is the supply of a going concern, and their agreement is recorded in a document; and
>
> (ii) the supplier and the recipient intend that the supply is of a taxable activity, or part of a taxable activity, that is capable of being carried on as a going concern by the recipient; or
>
> …

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

[2] Section 149A(2) of the Tax Administration Act 1994.

[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] *Lowe v CIR* (1981) 5 NZTC 61,006 (CA); *CIR v Canterbury Frozen Meat Co Ltd* (1994) 16 NZTC 11,150 (CA); *Golden Bay Cement Company Ltd v CIR* (1996) 17 NZTC 12,580 (CA); *CIR v New Zealand Wool Board* (1999) 19 NZTC 15,476 (CA); *Dandelion Investments Ltd v CIR* (2003) 21 NZTC 18,010 (CA).

26. "Going concern" is defined in s 2 as:

> "**Going concern**", in relation to a supplier and a recipient, means the situation where–
>
> (a) there is a supply of a taxable activity, or of a part of a taxable activity where that part is capable of separate operation; and
>
> (b) all of the goods and services that are necessary for the continued operation of that taxable activity or that part of a taxable activity are supplied to the recipient; and
>
> (c) the supplier carries on, or is to carry on, that taxable activity or that part of a taxable activity up to the time of its transfer to the recipient.

27. The Tax Counsel Office considered the law referred to by the parties and provided the following summary of principles:

- To be a supply of a going concern, there must be a supply of a taxable activity, or of part of a taxable activity that is capable of separate operation, that is "going" or capable of "going" at the time it is supplied. All the assets and business structures and processes must be supplied. The taxable activity supplied must be carried on up to the time of transfer.[6]
- The activity supplied must be a going concern at the time of supply, in this case being the earlier of the time an invoice is issued by the supplier, or the time at which any payment is received by the supplier.[7]
- The parties must record their agreement that a supply is to be the supply of a going concern in a document. The record must be in clear and unequivocal terms.[8]
- Clause 15 (or its equivalent) in the REINZ/ADLS standard form agreement meets the requirement for the agreement of the parties to be "recorded in a document" if there is a supply under the agreement to which section 11(1)(mb) (compulsory zero-rating) does not apply, but which comprises the supply of a taxable activity that is a going concern at the time of the supply.[9]
- The agreement for sale and purchase will usually be sufficient to show whether the parties had an intention to transfer a taxable activity that is capable of being carried on as a "going concern" by the recipient.[10]

28. The Tax Counsel Office considered that:

- The sale of the Property was simply the sale of an asset, without more, and did not amount to a supply of a part of the Taxpayer's taxable activity that was capable of separate operation. This was supported by the case law that shows a business process must accompany the sale of an asset for it to satisfy the "going concern" definition, even if most of the value in the business relates to the asset. This has been held to be the case in respect of the sale of key assets such as a charter yacht in a yacht chartering business (*Allen Yacht Charters*), an uncompleted property development in a property development business (*Case S78*), and a truck in a freight business (*Case 7/2011*). "Business process" includes (or may include) contracts with suppliers and customers, knowhow, and goodwill.
- While an asset of the business was transferred, not all of the business structure relating to the "property selling" part of the activity was transferred. Further, and importantly, there was no transfer of business process. There was simply the transfer of an asset of the Taxpayer's business to the purchaser. The Property, on its own, was not "going" in the required sense of that term. It did not give the purchaser an ability to generate income on an ongoing basis. Therefore, not all of the goods and services necessary for the continued operation of that part of the taxable activity were transferred to the purchaser.

[6] *Case M98* (1990) 12 NZTC 2,599 at 2,609; *Case N17* (1991) 13 NZTC 3,148 at 3,155; *Case M89* (1990) 12 NZTC 2,556; *Allen Yacht Charters Limited v CIR* (1994) 16 NZTC 11,270; *Case S78* (1996) 17 NZTC 7,488; *Case 7/2011* (2011) 25 NZTC 15,076; *Case P75* (1992) 14 NZTC 4,504.

[7] Section 9(1) of the GST Act.

[8] *Fatac Limited (in liquidation) v CIR* (2002) 20 NZTC 17,902 (CA); *Case W56* (2004) 21 NZTC 11,525; *Case W57* (2004) 21 NZTC 11,539; *Starrenburg v Mortre Holdings Ltd* (2004) 21 NZTC 18,696 (CA).

[9] *Fatac Limited (in liquidation) v CIR* (2002) 20 NZTC 17,902 (CA); *Starrenburg v Mortre Holdings Ltd* (2004) 21 NZTC 18,696 (CA).

[10] *Greenmount Manufacturing Ltd v Southbourne Investments Ltd* (2007) 23 NZTC 21,096 (CA); *Cockburn & Ors v CS Development No 2 Ltd* (2010) 24 NZTC 24,431 (CA); *Cockburn & Ors v CS Development No 2 Ltd* (2011) 25 NZTC 20,007 (SC).

29. Accordingly, the Tax Counsel Office concluded that the supply of the Property was not the supply of a going concern under s 11(1)(m) because:
    - The Property on its own was not a part of a taxable activity that was capable of separate operation. It was merely an asset of the Taxpayer's business.
    - The Taxpayer did not supply the purchaser with all of the goods and services necessary for the continued operation of part of a taxable activity. Again, the Property was merely an asset of the Taxpayer's activity. Not all of the business structure, and none of the business process relating to part of a taxable activity, were supplied.

Compulsory zero-rating

30. CCS argued the sale was not compulsorily zero-rated under s 11(1)(mb) because:
    - The vendor was required to assess at settlement whether the purchaser met the conditions for compulsory zero-rating and was entitled to rely on the information provided by the purchaser as at settlement in doing so.
    - The evidence showed that at settlement, the information available to the Taxpayer did not give the Taxpayer a sufficient basis for zero-rating the supply.
    - The Taxpayer had therefore failed to discharge the onus of proof in relation to the zero-rating of the supply under s 11(1)(mb).
31. CCS also argued that s 5(23) did not apply to shift the liability to pay GST to the purchaser.
32. The Taxpayer argued the sale was compulsorily zero-rated under s 11(1)(mb) because:
    - The purchaser did not indicate in the GST Schedule to the Agreement, either on signing or by the settlement date, whether it intended to use the Property for making taxable supplies. This left the Taxpayer in the position of having to make a judgment call.
    - Based on the purchaser's confirmation that it was GST registered, the Taxpayer decided that the purchaser was intending to use the Property for making taxable supplies.
    - The statements made by third parties should be disregarded.
33. The Taxpayer did not make any arguments in relation to s 5(23).
34. The compulsory zero-rating of land rules (CZR rules) were introduced on 1 April 2011 and treat certain business-to-business supplies involving land as zero-rated supplies. The key provision is s 11(1)(mb). Sections 5(23) and 78F are also relevant.
35. Section 11(1)(mb) states:

> **11 Zero-rating of goods**
>
> (1) A supply of goods that is chargeable with tax under section 8 must be charged at the rate of 0% in the following situations:
>
> …
>
> (mb) the supply wholly or partly consists of land, being a supply–
>
> (i) made by a registered person to another registered person **who acquires the goods with the intention of using them for making taxable supplies**; and
>
> (ii) that is not a supply of land intended to be used as a principal place of residence of the recipient of the supply or a person associated with them under section 2A(1)(c); or
>
> … [Emphasis added]

36. A supply of goods is chargeable with tax under s 8 if made by a registered person in the course or furtherance of their taxable activity.
37. Therefore under ss 8 and 11(1)(mb), a vendor must zero-rate a supply if:
    - the supply wholly or partly consists of land;
    - the vendor is GST-registered (or either will be GST registered or will be treated as GST registered) at the time of settlement;
    - the supply is being made by the vendor in the course or furtherance of their taxable activity;
    - the purchaser is GST-registered (or will be GST registered or treated as GST registered) at the time of settlement;
    - the purchaser acquires the goods (including the land) with the intention of using them (in whole or part) for making taxable supplies; and
    - none of the land included in the supply is intended to be used as the purchaser's principal place of residence or the principal place of residence of a relative of the purchaser.

38. The time at which the application of s 11(1)(mb) is tested is at the time of settlement.[11]

39. Section 5(23) determines what happens if a supply has been incorrectly zero-rated under s 11(1)(mb). Under s 5(23), if, after a transaction is settled, it is found that the supply should have been standard-rated rather than zero-rated, the purchaser is treated as making, on the settlement date, a supply of the goods in question at the standard rate. The value of the supply under s 5(23) will be equal to the amount of the consideration for the original supply.

40. A vendor may rely on information provided by the purchaser to decide whether a supply must be zero-rated under s 11(1)(mb).[12] In addition, s 78F(2) requires the purchaser to notify the vendor of certain facts at or before settlement, as follows:[13]

- they are, or expect to be, a registered person
- they are acquiring the goods with the intention of using them for making taxable supplies
- they do not intend to use the land as a principal place of residence for them or a person associated with them under section 2A(1)(c).

41. Under s 78F(3), the supplier may rely on the information provided by the recipient as required by s 78F(2). Section 78F(2) requires the recipient to provide the information at or before settlement.

42. It is also noted that under s 15B TAA, a taxpayer is obliged to correctly determine the amount of tax payable by the taxpayer under the tax laws.

43. In the current dispute, both the Taxpayer and the purchaser are GST registered. Further, the parties are agreed that:

- the supply wholly or partly consisted of land;
- the supply was made by the vendor (the Taxpayer) in the course or furtherance of its taxable activity; and
- none of the land included in the supply was intended to be used as the purchaser's principal place of residence or the principal place of residence of a relative of the purchaser.

44. Therefore the issue to be determined was whether the purchaser acquired the Property with the intention of using it, in whole or part, for making taxable supplies. In this regard the Taxpayer argued the purchaser had acquired the Property with the intention of using it for making supplies of short-stay accommodation or in a property selling activity, or both.

45. The Tax Counsel Office considered that the Taxpayer had failed to show that (at the time of settlement) the purchaser had acquired the Property with the intention of using it for making taxable supplies.

46. The Tax Counsel Office concluded that there was insufficient evidence to suggest that at settlement the purchaser intended to carry on a taxable activity of supplying shortstay accommodation from the Property. Further, the Taxpayer had failed to prove, on the balance of probabilities, that at settlement the purchaser had intended to use the Property in a property selling activity (whether in the course or furtherance of its existing taxable activity, or by commencing a new taxable activity of selling property). The Taxpayer was unable to rely on s 78F(3) because the revised Schedule 2 to the Agreement had been received after settlement.

47. Therefore the Tax Counsel Office decided that the Taxpayer had failed to show that CCS's proposed adjustment was wrong, and by how much it was wrong.

48. As CCS had asserted that s 5(23) did not apply to shift the liability for output tax on the supply to the purchaser, and the Taxpayer had not disputed CCS's assertion, the output tax liability would remain with the Taxpayer in this case (subject to whether the proposed amendment to the assessment was time-barred).

[11] Section 11(8B) states that whether a supply of goods is zero-rated under s 11(1)(mb) is determined at the time of settlement of the transaction relating to the supply.

[12] See s 78F(3).

[13] In this context "notify" means to give notice and, for a mode of communication, has the meaning set out in s 14C of the TAA – see s 2 GSTA. Section 14C of the TAA effectively requires the notice to be in writing, which can include email in certain circumstances.

Issue 3 | Take tuatoru: Did the time bar apply?

Time bar

49. All statutory references in this final part of the summary are to the TAA unless otherwise stated.
50. The issue was whether the time bar in s 108A applied on the facts.
51. CCS argued that s 108A(3) excluded the application of the time bar. This was on the basis that the Taxpayer had failed to show that:
    - the Commissioner did not honestly hold the opinion that the Taxpayer knowingly or fraudulently failed to disclose to the Commissioner all of the material facts necessary for determining the amount of GST payable for the GST disputed period; or
    - the opinion formed was one that was not reasonably open to the Commissioner on the information available to her.
52. The Taxpayer argued that:
    - the Commissioner had not provided any evidence that s 108A(3) applied. Accordingly the Taxpayer disagreed that the burden of proof rested on the Taxpayer to show that the Commissioner did not honestly hold the opinion; and
    - there was insufficient evidence for the Commissioner to form the view that it was "seriously arguable" that the Taxpayer knowingly or fraudulently failed to make full disclosure. The Taxpayer argued that there was in fact no evidence. The Taxpayer simply believed the sale was zero-rated and there was no material information to disclose.
53. Amending a GST assessment so as to increase the amount assessed is subject to the time bar provision in s 108A:

> **108A Time bar for amending GST assessment**
>
> (1) Subject to this section and section 108B, if a taxpayer provides a GST tax return for a GST return period and an assessment has been made, the Commissioner may not amend the assessment to increase the amount assessed if 4 years have passed from the end of the GST return period in which the tax return was provided.
>
> …
>
> (4) This section overrides every other provision of this Act, and any other rule or law, that limits the Commissioner's right to amend GST assessments.

54. The GST time bar in s 108A(1) prevents the Commissioner from increasing an assessment if four years have passed from the end of the GST return period in which the taxpayer provided their GST return. This is subject to some exceptions including those in s 108A(3) and s 108B. If any of the exceptions apply the Commissioner may amend an otherwise time-barred assessment.
55. Section 108A(3) contains an exception to the time bar:

> (3) The Commissioner may, at any time, amend an assessment to increase the amount of the assessment **if the Commissioner considers that the person assessed has knowingly or fraudulently failed to disclose to the Commissioner all of the material facts** that are necessary for determining the amount of GST payable for a GST return period.
>
> [Emphasis added]

56. Therefore, if the Commissioner considers that a taxpayer has knowingly or fraudulently failed to disclose all of the material facts necessary for determining the amount of GST payable, she may increase a GST assessment at any time.
57. To determine whether the time bar exception in s 108A(3) applied, the Tax Counsel Office identified the following principles from the relevant case law:
    - Based on a validly formed opinion made in good faith, the Commissioner must consider that the taxpayer has knowingly or fraudulently failed to disclose all of the material facts. The Commissioner has formed an "opinion" if she has reached a sufficiently concluded state of mind. It is not sufficient that the Commissioner reaches a conclusion that it is "seriously arguable" that the taxpayer has knowingly or fraudulently failed to disclose all of the material facts – the Commissioner must conclude that the taxpayer *has* knowingly or fraudulently failed to disclose all of the material facts.
    - A challenge to the Commissioner's opinion can only succeed if the taxpayer shows:
        - the Commissioner did not honestly hold the opinion, or
        - the Commissioner misdirected herself as to the legal basis on which the opinion was to be formed, or
        - the opinion was one that was not reasonably open to the Commissioner on the information available to her.[14]

[14] *Vinelight Nominees Limited v CIR (No 2)* (2005) 22 NZTC 19,519 (HC) at [26]; *Case Q58* (1963) 15 NZTC 5,330 at 5,349; *Maxwell v CIR* [1962] NZLR 683 (CA); *Auckland Institute of Studies v CIR* (2002) 20 NZTC 17,685 (HC) at [102].

- "Knowingly" requires knowledge of the existence of facts where there is an element of wrongdoing in the failure to disclose.[15]
- "Fraudulently" requires that the person filing the return must have known that they were not disclosing all of the material facts and nevertheless dishonestly or deceitfully withheld the information. Or the person must have been recklessly careless in not disclosing all of the material facts.[16]
- Where a company is involved, knowledge and fraudulence are imputed via a responsible officer.[17]
- Disclosure is not limited to what is contained in the GST return. Regard is given to the whole of the information that the Commissioner may be expected to treat as made available, including information disclosed in other documents. However, the taxpayer must make a reasonably explicit or implicit indication as to where the other material may be found.[18]
- "All of the material facts" include all facts a person knows or is capable of knowing, which are material to determining the correct tax payable. A taxpayer cannot leave the Commissioner to speculate as to the facts. However, there will be no failure to disclose all material facts merely because:
  - immaterial facts have not been disclosed, or
  - the taxpayer incorrectly applied the law to the facts.[19]

58. In disputes involving s 108A(3), there is a threshold onus on the Commissioner to show that she has formed an opinion on the correct legal basis that is honestly held and based on the available evidence. To put it another way, the Taxpayer can discharge the onus of proof by showing that:
    - the Commissioner did not honestly hold the opinion
    - the Commissioner misdirected herself as to the legal basis on which the opinion was to be formed, or
    - the opinion was one not reasonably open to the Commissioner on the information available to her.
59. The Tax Counsel Office considered that the Commissioner had proved she had reached a sufficiently concluded state of mind to form an opinion the Taxpayer knowingly failed to disclose material facts to the Commissioner. The Tax Counsel Office agreed with CCS that the Commissioner must conclude that the Taxpayer had knowingly failed to disclose material facts, rather than that it was seriously arguable the Taxpayer had knowingly failed to disclose material facts.
60. The Tax Counsel Office further considered the Taxpayer had not proved the Commissioner did not honestly hold the opinion.
61. The Tax Counsel Office noted the Taxpayer had not argued the Commissioner had misdirected herself as to the legal basis on which the opinion was to be formed.
62. However, the Tax Counsel Office concluded that the Taxpayer had shown the opinion was one which was not reasonably open to the Commissioner on the information available to her. This was because:
    - The Taxpayer had provided the purchaser with a settlement statement and GST invoice prior to settlement showing the supply of the Property was zero-rated. The purchaser had not corrected either document.
    - The purchaser's GST information in Schedule 2 to the Agreement was incomplete when the Agreement was signed and had not been amended by settlement, and the purchaser stated on taking possession of the Property they had not decided what to do with the Property.
    - The Taxpayer had subsequently sought and received written confirmation from the purchaser of the GST information that had not been provided in Schedule 2 to the Agreement and had relied on that information in filing its return.

[15] *Meulen's Hair Stylists v CIR* [1963] NZLR 797 (NZSC) at 798–799.

[16] *R v Coombridge* [1976] 2 NZLR 382 (CA) at 387.

[17] *Meulen's Hair Stylists* at 799.

[18] *FB Duvall Limited v CIR (No 2)* (1998) 18 NZTC 13,943 at 13,952-13953; *Case U144* 87 ATC 836 at [23]; *Stamp v FCT* 88 ATC 4803 at 4,810; *Case 17/2006* [2006] AATA 1013; (2006) ATC 239.

[19] *Scottish Australian Mining Co Ltd v FCT* [1950] HCA 16, (1950) 81 CLR 188 at [11]; *Austin Distributors Pty. Limited v FCT* (1964) 13 ATD 429 (HCA) at 432–433; *Stapleton v FCT* 89 ATC 4818 (FCA); *W. Thomas & Co. Pty. Limited v FCT* (1965) 14 ATD 78 (HCA) at 89.

63. The Tax Counsel Office considered the Taxpayer had been justified in relying on a document received from the purchaser in determining the correct tax position, as was required of the Taxpayer by s 15B. The available evidence suggested the Taxpayer filed its GST return believing its position to be correct.

64. Accordingly, CCS's position that the time bar exception in s 108A(3) applied was not accepted. The proposed amendment to the assessment was time-barred.

TDS 22/11: "Negative income" adjustment, RWT credit, time bar

Technical decision summary: Adjudication

Decision date | Te Rā o te Whakatau: 1 February 2022

Issue date | Te Rā Tuku: 16 June 2022

Subjects | Ngā kaupapa

Income Tax: Whether the Taxpayer is entitled to a "negative income" adjustment as a consequential adjustment to avoid double taxation. Whether the time bar applies. Whether the Taxpayer is entitled to the resident withholding tax (RWT) credit it claimed. Whether the net loss amount should be adjusted.

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

CCS	Customer & Compliance Services, Inland Revenue
Commissioner	Commissioner of Inland Revenue
ITA 2007	Income Tax Act 2007
RWT	Resident withholding tax
SOP	Statement of Position
TAA	Tax Administration Act 1994

Taxation laws | Ngā ture tāke

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

Facts | Ngā meka

1. The Taxpayer is a company.
2. The dispute concerns amounts that the Taxpayer included in an assessment of income tax:
   - A negative income amount included by the Taxpayer as a purported adjustment of previous year income.
   - A resident withholding tax (**RWT**) credit.
   - A net loss. The parties agree that the correct net loss amount is less than the amount claimed. The inclusion of a larger figure appears to have been a keying error by Inland Revenue.
3. Customer & Compliance Services, Inland Revenue (**CCS**) proposed adjustments to remove the first two and reduce the third of these amounts in the Taxpayer's assessment. The Taxpayer rejected the proposed adjustments and argued the time bar applied preventing the Commissioner from making the adjustments.
4. The Taxpayer filed three documents purporting to be income tax returns for the income tax year in question (the income year).
5. The first document (using a paper IR4 Company income tax return form) was received by Inland Revenue five months before the end of the income year. The IR4 form was completed by the Taxpayer's director and included the three disputed amounts.[1]
6. The first document was rejected by Inland Revenue's FIRST computer system because it was received before the end of the income year.
7. The second document was filed eight months after the end of the income year. This document was accepted by Inland Revenue as an income tax return and led to an assessment being recorded in Inland Revenue's FIRST computer system.

[1] See above at [2]. In the first document the correct (smaller) "net loss" amount was shown.

8. The amounts claimed in the second document were the same as in the first document, except the net loss was recorded in Inland Revenue's FIRST computer system as the larger amount rather than the correct (smaller) amount.
9. The third document was filed almost a year after the second document. It is not known why the third document was filed.
10. The third document was treated as a duplicate return. Inland Revenue contacted the Taxpayer about the return and was advised by its director that the original return filed (which was taken to mean the second document) was the correct return.
11. One of the issues in dispute (relevant to the time bar) was whether the first document referred to above was a valid return that resulted in an assessment. The Taxpayer argued it was valid and it did result in an assessment. CCS argued it did not. CCS argued only the second document resulted in an assessment.
12. Shortfall penalties were not pursued as part of this dispute.

Issues | Ngā take

13. There were two main issues in this dispute:
    - Whether it was correct for the Taxpayer to include a negative income amount in the Taxpayer's assessment for the income year as a consequential adjustment to avoid double taxation.
    - Whether the time bar applied to prevent CCS from making its proposed adjustments.
14. The secondary issues in dispute both depended on whether the time bar applied:
    - Whether it was correct for the Taxpayer to include the RWT credit in its return for the income year.
    - Whether CCS was entitled to reduce the net loss from the larger amount down to the smaller amount.

Decisions | Ngā whakatau

15. The Tax Counsel Office reached the following decisions on the issues:
    - It was not correct for the Taxpayer to include the negative income amount in its return.
    - The time bar in s 108 of the Tax Administration Act 1994 (**TAA**) did not prevent the Commissioner from amending the assessment for the income year.
    - It was not correct for the Taxpayer to include the RWT credit in its return.
    - The correct net loss was the smaller amount.

Reasons for decisions | Ngā take mō ngā whakatau

Issue 1 | Take tuatahi: Negative income adjustment

16. The Taxpayer argued the negative income amount related to its participation in a tax avoidance arrangement. The Taxpayer argued that in response to the arrangement income derived by the Taxpayer had been assessed to another taxpayer under s GA 1. The Taxpayer argued the income must be reversed out of its assessments under s GA 1(6) to avoid double taxation.
17. The Taxpayer argued that by including the negative income amount in its return for the income year it had applied the rule in s GA 1 to exclude the income returned by it in previous income years (13-15 years ago) (the previous income years).
18. Where an arrangement is void under s BG 1, s GA 1(2) gives the Commissioner the power to adjust the taxable income of a person affected by the arrangement.
19. If, under s GA 1(2) the Commissioner includes an amount of income in calculating the taxable income of the person, the income must not be included in calculating the taxable income of another person. Therefore, s GA 1(6) may require the Commissioner to make consequential adjustments to ensure that income is not included in the taxable income of more than one person.
20. CCS argued that:
    - The Taxpayer had not satisfied the onus of proving that an adjustment is required under s GA 1(6).
    - No evidence was held or provided to show that the Taxpayer returned income in the previous income years.
21. The Taxpayer argued it maintained a full schedule of the amounts of the Taxpayer's income that were attributed to another taxpayer by the Commissioner under s GA 1(6). The Taxpayer argued that the schedule was relied upon to support the Taxpayer's compensating adjustment under s GA1(6) Income Tax Act 2007.

22. This schedule was not included in the evidence for this dispute.
23. In response to a request by CCS, the Taxpayer provided some additional income information for the previous income years. However, as argued by CCS, the amounts were considerably less than the negative income amount claimed by the Taxpayer.
24. Based on the information provided, the Tax Counsel Office concluded that the Taxpayer has not shown it was correct to include the negative income adjustment in its return for the income year. The Taxpayer has not shown its assessments for the previous income years included such an amount.
25. Even if a consequential adjustment was required to remove income from the taxable income of a person, the Tax Counsel Office considered the adjustment would need to be made in the periods in which the income was originally included. This was because the allocation of income to a particular year and, by extension, the reversal of such allocation, has important implications within the scheme of the income tax legislation. For example, tax rates may be different between different years and the availability of losses or imputation credits can differ between different years. An adjustment in a different income year may not have the same effect. There is also no provision authorising the making of adjustments in a later income year. This is a further reason why it was not correct for the Taxpayer to include the negative income adjustment in its 2017 income tax return.
26. In summary, the Tax Counsel Office concluded:
    - The Taxpayer had not shown the negative income adjustment that it claimed was necessary.
    - Even if such an adjustment was necessary, the adjustment would need to be made in the previous income years, not the income year.
    - The negative income amount should be removed from the Taxpayer's assessment for the income year, as proposed by CCS.

Issue 2 | Take tuarua: Whether the time bar applies

27. Legislative references in Issue 2 are to the TAA unless otherwise stated.

Time bar

28. The issue is whether the time bar in s 108 prevented CCS from amending the Taxpayer's income tax assessment for the income year. This depends on when the Taxpayer filed its return for the income year.
29. As discussed above in the facts, the Taxpayer provided three different documents which purported to be income tax returns for the income year. The Taxpayer argued the first of these documents was a valid return and it resulted in an assessment. If this was true, the timing of this return would mean that the time bar would apply (subject to time bar exceptions).
30. CCS argued the first document was not a valid return. CCS argued only the second document was a valid return. The time of filing the second document would mean that the time bar would not apply.
31. Subject to time bar exceptions, s 108(1) prevents the Commissioner from amending an assessment, by increasing the amount assessed or decreasing the amount of a net loss, if:
    - the taxpayer has filed an income tax return, and
    - an assessment has been made, and
    - four years have passed from the end of the tax year in which the taxpayer provides the tax return.

Section 33

32. CCS argued the first document filed by the Taxpayer was not a valid income tax return because it was filed before the end of the tax year. CCS argued this view was supported by the wording of s 33 of the TAA.
33. Section 33 states that "in each tax year" a taxpayer (other than certain taxpayers to whom other rules apply) must furnish a return of income "for the preceding tax year".
34. The wording of s 33 requires an income tax return for a particular tax year to be filed in the subsequent tax year.[2] The Taxpayer did not do this. The Taxpayer filed the first document almost five months before the income year had ended.

[2] Note that this wording would not prevent a taxpayer who has elected and received consent to file returns to a late balance date (under s 38) from filing before the end of their income year, but after 31 March of the corresponding tax year. It would still be questionable whether this return was valid based on a potential lack of certainty.

35. The Tax Counsel Office noted that s 33(1) of the TAA was subsequently amended and in the later version there is no reference to a preceding tax year.[3] The Tax Counsel Office considered that the change in wording does not support the Taxpayer's argument (that a return can be filed before the end of an income year) because:
    - the amendment does not apply to the income year; and
    - there is no indication in the commentary to the amending legislation that the removal of the words "for the preceding tax year" was intended to result in any change in meaning.

A return must be definitive

36. CCS argued filing an income tax return early could result in income or expenses not being included or law changes not being accounted for, resulting in incorrect tax positions.
37. An income tax assessment is important because it quantifies the liability for tax that is imposed on a taxpayer for an income year under the legislation. The importance of the assessment process means that an assessment cannot be tentative, provisional, subject to adjustment, or conditional. The quantification of liability must be definitive at the time it is made and final subject only to challenge through the objection process.[4]
38. It is noted *CIR v Canterbury Frozen Meat Co Ltd* was decided before the introduction of taxpayer self-assessment and was concerned with an assessment made by the Commissioner. Nevertheless, the Tax Counsel Office considered that the same principle would apply to taxpayer selfassessments. The assessment process is no less important because the assessment is made by a taxpayer rather than the Commissioner. Taxpayer assessments will often be the only assessment made for a period. It follows that a taxpayer self-assessment must also be definitive.
39. The Taxpayer filed its return almost five months before the end of the income year. Filing the return early raises doubt about whether the first document provided a definitive quantification of the Taxpayer's liability to tax for the income year.
40. In hindsight, it appears that the company was not actively carrying on a business during the income year. Four years after the end of the income year the Taxpayer's director provided a copy of the Taxpayer's financial accounts for the income year showing no income and a small claim for expenses (accounting fees). However, at the time the first document was filed (almost five months before the end of the income year), it was not necessarily certain that the particulars of the return would not change further. The Taxpayer has not explained how it could have certainty about the assessment when the return was filed.
41. The onus of proof is on the Taxpayer. The Tax Counsel Office concluded that the Taxpayer had not satisfied the onus of proving that the first document provided a definitive quantification of the Taxpayer's liability to tax for the income year.

The overriding effect of s 108

42. The Taxpayer argued s 108 has overriding effect and that even if there was a technical breach of s 33, s 108 overrides s 33 and prevents CCS from making the proposed adjustments.
43. The Taxpayer referred to s 108(3), which provides that s 108 overrides every other provision of the Act, and any other rule of law, that limits the Commissioner's right to amend assessments. The Taxpayer also referred to s 108(4) which states that subs (1) applies to all returns filed on or after 1 April 1997. The Taxpayer argued this wording clearly applied to the first document that it filed.
44. Section 108 does have overriding effect, but for s 108 to override anything, it must first apply. For section 108 to apply as argued by the Taxpayer, the first document must have been a valid return. Whether the return was valid will determine whether s 108 applies.
45. Further, s 108(3) states that it overrides any rule of law that limits the Commissioner's right to amend assessments. As argued by CCS, s 33 does not limit the Commissioner's right to amend assessments. Section 33 requires a person to file a return.
46. Section 108(4) does not assist the Taxpayer. The effect of subs (4) is that s 108 does not apply to returns filed before 1 April 1997. For s 108 to apply to returns filed on or after 1 April 1997, the other requirements of s 108 must also be satisfied. Unless these requirements are satisfied, the overriding effect of s 108 will not be engaged.

[3] For more information on the changes made at this time see *Tax Information Bulletin* Vol 31, No 4 (May 2019).

[4] *CIR v Canterbury Frozen Meat Co Ltd* (1994) 16 NZTC 11,150 (CA).

Conclusion – the first document was not a valid return

47. The Tax Counsel Office concluded that the first document filed by the Taxpayer was not a valid return. This is because:
    - The wording of s 33 requires an income tax return for a particular tax year to be filed in the subsequent tax year.
    - The subsequent amendment to s 33 does not support the Taxpayer's position.
    - The Taxpayer has not satisfied the onus of proving that the first document provided a definitive quantification of the Taxpayer's liability to tax for the income year.
    - The overriding effect of s 108 does not support the Taxpayer's position because s 108 does not apply.
48. This means that a valid return was not filed, and an assessment was not made, until the second document was provided. Consequently, the Tax Counsel Office concluded that the income year was not time barred.

Issue 3 | Take tuatoru: RWT credit and net loss

49. The secondary issues in dispute both depended on whether the time bar applies. Since the time bar did not apply, it was necessary for the Tax Counsel Office to consider:
    - Whether it was correct for the Taxpayer to include the RWT credit in its return for the income year.
    - Whether CCS was entitled to reduce the net loss from the larger amount down to the smaller amount.

RWT adjustment

50. CCS proposed to remove the RWT credit from the Taxpayer's assessment for the income year.
51. Although the Taxpayer has not explicitly conceded this issue, the Taxpayer had stated that the amount that it included in the return as RWT related to imputation credits, not RWT. Therefore, it was clear that the Taxpayer was not entitled to a RWT credit in the income year because no evidence was provided to the Tax Counsel Office to show that a RWT credit was available.
52. It follows that the Taxpayer was not entitled to the refund that resulted from the RWT credit. The Tax Counsel Office noted there is no mechanism in the legislation where excess imputation credits can be paid to a taxpayer as a refund. This was not disputed by the Taxpayer.
53. The Taxpayer's only apparent objection to the proposed adjustment to remove the RWT credit was based on its argument that the time bar prevents CCS from making the adjustment.
54. As noted above, the time bar did not apply. Therefore, the Tax Counsel Office concluded the assessment should be adjusted to remove the RWT credit claimed. As a consequence of the RWT credit adjustment, the Taxpayer will also be liable to repay the refund and use of money interest that it received as a result of the RWT credit claimed.

Net loss adjustment

55. CCS also proposed to reduce the net loss from larger (incorrect) amount down to smaller (correct) amount.
56. The Taxpayer agreed the smaller amount is the correct figure. The entry of the larger amount appeared to have been a keying error by Inland Revenue.
57. Again, the Taxpayer's only apparent objection to the proposed adjustment is based on its argument that the time bar prevents CCS from making the adjustment. Since the time bar does not apply, the Tax Counsel Office concluded the assessment should be adjusted to reduce the net loss as proposed by CCS.

TDS 22/12: "Negative income" adjustment – Shortfall penalties

Technical decision summary: Adjudication

Decision date | Te Rā o te Whakatau: 1 February 2022

Issue date | Te Rā Tuku: 16 June 2022

Subjects | Ngā kaupapa

Income tax: Whether the Taxpayer was correct to include the negative income adjustment in its income tax return to prevent income being taxed twice. Whether the Taxpayer is liable for shortfall penalties.

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

CCS	Customer & Compliance Services, Inland Revenue
Commissioner	Commissioner of Inland Revenue
ITA 2007	Income Tax Act 2007
TAA	Tax Administration Act 1994

Taxation laws | Ngā ture tāke

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

Facts | Ngā meka

The Taxpayer's business

1. The Taxpayer is a company. The Taxpayer conducted a consulting business.
2. Subsequently, over a period of two decades, the Taxpayer's business was transferred between a number of different ownership entities. During this time, the Taxpayer had no direct ownership interest in the consulting business.
3. The business income of each of those different ownership entities was reassessed to another person under an avoidance reconstruction. This reconstruction was made under provisions in earlier legislation corresponding to what is now s GA 1.
4. The reconstruction of the income to the other person was disputed. The dispute was finally resolved when the reconstruction was approved by the Court of Appeal.

The Taxpayer's self-assessment

5. The Taxpayer filed its income tax return for the income tax year in question (the income year) and included a negative income amount as other income.
6. The Taxpayer included this negative income amount as an adjustment to remove income that the Taxpayer argued was both returned by the Taxpayer and reconstructed to another taxpayer as part of the reconstruction of a tax avoidance arrangement. The Taxpayer argued the adjustment is required to avoid taxing the same income in the hands of two taxpayers (s GA 1(6)).
7. Customer & Compliance Services, Inland Revenue (**CCS**) did not accept the negative income adjustment was correct or necessary. Therefore, CCS proposed to adjust the Taxpayer's income tax return by removing the negative income amount from the assessment for the income year.

Shortfall penalty adjustments

8. CCS also proposed the following shortfall penalties as alternatives (in order of priority):
    - Abusive tax position shortfall penalty
    - Gross carelessness shortfall penalty
    - Unacceptable tax position shortfall penalty
    - Not taking reasonable care shortfall penalty
9. Shortfall penalties are calculated based on a tax shortfall amount. The tax shortfall used by CCS for the proposed penalties did not include the tax effect of deductions claimed by the Taxpayer that were the subject of a voluntary disclosure.[1]
10. For all penalty types, CCS proposed a reduction of 50% for previous behaviour (s 141FB of the TAA). Further, in the case of the unacceptable tax position and not taking reasonable care penalties, the penalty is proposed to be at the cap of $50,000 (s 141JAA of the TAA).

Issues | Ngā take

11. The issues considered in this dispute were:
    - Whether the Taxpayer was correct to include the negative income adjustment in its income tax return for the income year to prevent income being taxed twice.
    - Whether the Taxpayer is liable for the shortfall penalties proposed by CCS.

Decisions | Ngā whakatau

12. The Tax Counsel Office reached the following decisions on the issues:
    - It was not correct for the Taxpayer to include the negative income amount in its return.
    - The Taxpayer is liable for a shortfall penalty for taking an abusive tax position, reduced by 50% for previous behaviour as proposed by CCS.

Reasons for decisions | Ngā take mō ngā whakatau

Issue 1 | Take tuatahi: Negative income adjustment

13. There is no dispute that when challenging a tax avoidance arrangement the Commissioner is allowed to pursue assessments of different taxpayers for the same income. However, ultimately, once the challenge to the tax avoidance arrangement is complete, the Commissioner is required under s GA 1(6) to ensure that the same income is not taxed to more than one person.[2]
14. The Taxpayer argued the same income has been taxed twice, once to the Taxpayer and again to the other person. For an adjustment to be required to the Taxpayer's assessment under s GA 1(6), the Taxpayer would need to establish that it did, in fact, return this income. The Taxpayer argued it has filed income tax returns in the relevant periods that included its share of the amounts.
15. CCS argued the Taxpayer has not paid any income tax in relation to the amount that the Taxpayer argued must be reversed, not during the income year or any earlier year.
16. The available evidence indicated the amount assessed to the other person was made up of income and losses of the different ownership entities. The amount did not include any income of the Taxpayer. In other words, the Taxpayer has not provided any evidence that it returned amounts that were reassessed to the other person.
17. Therefore, the Taxpayer had not satisfied the onus of proving that it had returned income that was reassessed to the other person.
18. It did not assist the Taxpayer that the Taxpayer owned the consulting business before it was transferred to the different ownership entities, or that the Taxpayer later reacquired the business. Income tax is assessed to a person who derives income from a business, not to the business itself. Further, income is assessed for particular years. The Taxpayer did not own the business during the relevant income years and did not derive (or return) the income that was assessed to the other person.

[1] The Taxpayer voluntarily disclosed that legal fees had been incorrectly claimed in the income year.

[2] *Miller v Commissioner of Inland Revenue* [2001] 3 NZLR 316 (PC) at [33], *Russell v CIR* (2012) 25 NZTC ¶20-120; [2012] NZCA 128 at [84].

19. For the above reasons, the Tax Counsel Office concluded that it was not correct for the Taxpayer to include the negative income adjustment in its own assessment.

Whether the income year would have been the correct year to make an adjustment

20. The Taxpayer argued the income year was the correct income year to include the negative income adjustment. This is because this was the year in which the other person's challenge proceedings were finally resolved.
21. CCS argued that if an adjustment was required, it would need to be made in the periods in which the income was originally returned.
22. The Tax Counsel Office considered that, if an adjustment was required (it was not), the adjustment would need to have been made in the periods in which the income was originally included. This is because the allocation of income to a particular year (required under s BD 3) and, by extension, the reversal of such allocation, has important implications within the scheme of the income tax legislation. For example, tax rates may be different between different years and the availability of losses or imputation credits can differ between different years. An adjustment in a different income year may not have the same effect. There is also no provision authorising the making of adjustments in a later income year.
23. The definition of "day of determination of final liability" referred to by the Taxpayer does not assist the Taxpayer. That term is relevant to the timing of the refund, payment, or application of tax that has been paid by a disputant, following a successful challenge by the disputant (s 138I of the TAA). This dispute concerned an adjustment to the allocation of income to an income year, not a payment, refund or application of tax that might flow from such an adjustment.
24. These are further reasons why it was not correct for the Taxpayer to include the negative income adjustment in its income tax return for the income year.

Conclusion

25. The Tax Counsel Office concluded that it was not correct for the Taxpayer to include the negative income adjustment in its income tax return for the income year.

Issue 2 | Take tuarua: Shortfall penalties

26. Legislative references in Issue 2 are to the TAA unless otherwise stated.
27. CCS proposed the following penalties as alternatives (in order of priority):[3]
    - Abusive tax position shortfall penalty
    - Gross carelessness shortfall penalty
    - Unacceptable tax position shortfall penalty
    - Not taking reasonable care shortfall penalty
28. Shortfall penalties are calculated based on a tax shortfall amount. For all penalty types, CCS proposed a reduction of 50% for previous behaviour (s 141FB). Further, in the case of the unacceptable tax position and not taking reasonable care penalties, the penalty was proposed to be at the cap of $50,000 (s 141JAA).
29. In this case the Tax Counsel Office considered:
    - The Taxpayer took a tax position by including a negative amount as "other income" in its tax return for the income year. This resulted in a higher tax loss amount available to carry forward to the subsequent income year.
    - The correct tax position was that no negative income adjustment should have been made.

Abusive tax position shortfall penalty

30. The abusive tax position shortfall penalty in s 141D was considered in the Interpretation Statement "Shortfall Penalty for Taking an Abusive Tax Position".[4] Despite later case law, the Tax Counsel Office considered the Statement correctly stated the law in relation to the penalties.
31. Section 141D imposes a shortfall penalty on a taxpayer if the following requirements are satisfied:
    - The taxpayer has taken a "taxpayer's tax position".

[3] If the requirements of more than one penalty are satisfied, the highest shortfall penalty will apply (s 149(2) and (3)).

[4] Published in *Tax Information Bulletin* Vol 18, No 1 (February 2006) at 24.

- The taxpayer's tax position has led to a tax shortfall.
- The tax position is an "unacceptable tax position". A tax position will be an unacceptable tax position if:
  - the tax position, viewed objectively, fails to meet the standard of being about as likely as not to be correct, and
  - none of the exceptions in s 141B(1B) to (1D) apply.
- The tax position is an "abusive tax position". This means that, in addition to being an unacceptable tax position, viewed objectively, the tax position must be one the taxpayer takes:
  - in respect, or as a consequence, of an arrangement entered into with a dominant purpose of avoiding tax (s 141D(7)(b)(i)), or
  - where the tax position does not relate to such an arrangement, with a dominant purpose of avoiding tax (s 141D(7)(b)(ii)).

32. The amount of the penalty is 100% of the resulting tax shortfall.

Unacceptable tax position

33. For an abusive tax position shortfall penalty to apply to a tax position, the tax position must be an "unacceptable tax position".
34. A taxpayer's tax position will be an unacceptable tax position if, viewed objectively, the tax position:
    - fails to meet the standard of being about as likely as not to be correct, and
    - none of the exceptions in s 141B(1B) to (1D) apply.
35. The application of s 141B(1B) to (1D) were not raised and do not appear to be relevant in this case.
36. The Tax Counsel Office summarised that a tax position will be "about as likely as not to be correct" if:
    - the tax position is close to or around 50% likely to be correct[5]
    - the merits of the arguments supporting the tax position are substantial[6]
    - on balance, the tax position is one that, while wrong, could be argued on rational grounds to be right[7]
    - there must be room for a real and rational difference of opinion[8]
    - the taxpayer's tax position is one about which "reasonable minds could differ".[9]

Determining whether a tax position is "about as likely as not to be correct"

37. Section 141B(1) states that a taxpayer takes an unacceptable tax position if, viewed objectively, the tax position fails to meet the standard of being about as likely as not to be correct. Applying the standard objectively means that whether the taxpayer believed its tax position was "about as likely as not to be correct" is not relevant.[10]
38. The fact that a taxpayer may have received positive advice concerning the tax position taken is not relevant in determining whether the tax position was about as likely as not to be correct. The correctness of a tax position must be viewed objectively. Advice may affect a taxpayer's belief in the correctness of a tax position, but not the actual correctness. This is confirmed in *Alesco* at [142] and [143].[11]
39. The matters that must be considered in determining if the taxpayer's tax position is about as likely as not to be correct include (s 141B(7)):[12]
    - The actual or potential application to the tax position of all the tax laws that are relevant (including specific or general anti-avoidance provisions).
    - Decisions of a court or a TRA on the interpretation of tax laws that are relevant (unless the decision was issued up to one month before the taxpayer takes the taxpayer's tax position).

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

[6] *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115, (2009) 24 NZTC 23,188.

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

[8] *Walstern*.

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

[10] *Ben Nevis*.

[11] *Alesco New Zealand Ltd v CIR* [2013] NZCA 40, (2013) 26 NZTC 21-003.

[12] Whether there is an unacceptable tax position is determined at the time the taxpayer's tax position is taken (s 141B(5) and (6)).

40. In *Case U47* Judge Barber commented that s 141B(7), in effect, affirms and endorses the criminal maxim that ignorance of the law is no excuse.
41. CCS argued the tax position taken by the Taxpayer was not about as likely as not to be correct because the income that the Taxpayer purported to adjust in its return was not the Taxpayer's income in the first place.
42. The Tax Counsel Office considered that the Taxpayer had not established the negative income amount was included in the Taxpayer's income in the first place. As noted earlier, the available evidence indicated the amount assessed to the other person was made up of income and losses of the different ownership entities. The amount did not include any income of the Taxpayer.
43. Given the lack of evidence, the Tax Counsel Office considered that the tax position taken by the Taxpayer does not have substantial merit and could not be argued on rational grounds to be right. Therefore, the tax position was not about as likely as not to be correct and, therefore, was an unacceptable tax position.

Dominant purpose of avoiding tax

44. To be liable for an abusive tax position shortfall penalty a taxpayer must take an "abusive tax position" (s 141D(2)). "Abusive tax position" is defined in s 141D(7).
45. Section 141D(7)(a) requires that the tax position be an unacceptable tax position. As noted above, the Tax Counsel Office concluded that there was an unacceptable tax position.
46. Section 141D(7)(b) requires that the tax position taken by the taxpayer involves a dominant purpose of avoiding tax.

Purpose of an arrangement or of the taxpayer

47. Section 141D(7)(b)(i) and (ii) indicate that the dominant purpose can be that of an arrangement or of the taxpayer.
48. In the present case, the tax position taken (claiming the negative income adjustment) was not part of an arrangement. The tax position was one taken by the Taxpayer in reliance on s GA 1(6). An adjustment made under s GA 1(6) is made as a consequence of a tax avoidance reconstruction. Although there is a connection to a tax avoidance arrangement, the adjustment made by the Taxpayer was not part of the arrangement, ie it wasn't part of the plan.
49. Where the tax position does not relate to an arrangement, the tax position must be one that the **taxpayer** takes with a dominant purpose of avoiding tax (s 141D(7)(b)(ii)). Although this appears to require a subjective inquiry as to the taxpayer's purpose, the words "viewed objectively" in s 141D(7)(b) indicate that the taxpayer's purpose must be determined objectively. The Tax Counsel Office considered that determining the purpose of the taxpayer objectively can be achieved by testing the taxpayer's statements as to their purpose by reference to objective factors.[13]

Avoiding tax

50. The term "avoiding tax" is not defined in the TAA.
51. The Tax Counsel Office considered that "avoiding tax" includes tax avoidance to which the anti-avoidance provisions of the Act would apply. However, it also includes the avoidance of tax in a broader sense under general tax laws. This is supported by s 141D(6), which states that a tax position can be an abusive tax position under a general tax law or an anti-avoidance tax law.[14]

Dominant purpose

52. The abusive tax position shortfall penalty only applies when there is a dominant purpose of avoiding tax. "Dominant purpose" is not defined in the TAA.
53. The Concise Oxford English Dictionary defines "dominant" as "Exercising chief authority or rule: ruling, governing, commanding; most influential".[15] The same dictionary defines "purpose" as the "reason for which something is done, or for which it exists; the end to which an object or action is directed; aim…".
54. Case law has interpreted the term "dominant purpose" as the most influential, important, prevailing, or ruling purpose.[16]

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

[14] Taxpayer Compliance, Penalties, and Disputes Resolution Bill: Commentary on the Bill (September 1995) at 15 and 16, *Honk Land Trustees Ltd v CIR* (2016) 27 NZTC ¶22-055 at [63].

[15] *Oxford English Dictionary* (Online ed, Oxford University Press, 28 January 2022).

[16] *FCT v Spotless Services Ltd* 96 ATC 5,201 at 5,206, *National Distributors* at 6,350.

55. Indicators of a dominant purpose of avoiding tax may include artificiality, contrivance, circularity of funding, concealment of information and non-availability of evidence, and spurious interpretations of tax laws.[17] A spurious interpretation covers situations where a tax position taken has no or very little basis at law or in the interpretation made or position taken is frivolous.

56. Given the lack of evidence provided by the Taxpayer it returned any of this income (eg, income tax returns or financial statements), the Tax Counsel Office considered the tax position taken by the Taxpayer did not have substantial merit and could not be argued on rational grounds to be right. Therefore, the tax position was not about as likely as not to be correct and, therefore, was an unacceptable tax position.

57. Viewed objectively, based on the Taxpayer's current director's experience, their role with the Taxpayer, and the available information it is considered that Taxpayer's current director would have known there was no basis for the negative income adjustment. Given this, the Tax Counsel Office concluded that the Taxpayer's current director took the tax position with a dominant purpose of avoiding tax.

58. In summary, the Tax Counsel Office concluded that the taxpayer is liable for an abusive tax position shortfall penalty. As proposed by CCS, this penalty was reduced by 50% for previous behaviour (s 141FB).

The other penalties proposed as alternatives

59. CCS also proposed alternative shortfall penalties (including the gross carelessness, unacceptable tax position, and not taking reasonable care penalties). The Tax Counsel Office decided that the requirements of these penalties were also satisfied. However, under s 149(3) of the TAA, where the requirements of more than one penalty are met, the highest penalty applies (in this case, the abusive tax position shortfall penalty).

60. In brief summary, the Tax Counsel considered:

Gross carelessness

- A reasonable person in the Taxpayer's circumstances would have foreseen a high risk of a tax shortfall occurring as a result of claiming the negative income adjustment. In other words, a reasonable person would have checked to make sure that it was correct to make the negative income adjustment (including checking that the amount had been returned by the Taxpayer in its returns).

Unacceptable tax position

- Unacceptable tax position was considered above at [33]-[36] and it was concluded there that the position taken by the Taxpayer was unacceptable.[18]

Not taking reasonable care

- For the same reasons as given above for the gross carelessness shortfall penalty, it was also concluded that the Taxpayer did not take reasonable care in taking its tax position.[19]

[17] Taxpayer Compliance, Penalties, and Disputes Resolution Bill: Commentary on the Bill (September 1995).

[18] As proposed by CCS, this penalty would be capped at $50,000 under s 141JAA.

[19] As proposed by CCS, this penalty would also be capped at $50,000 under s 141JAA.

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Tax Counsel Office

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