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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 **ird.govt.nz/subscription-service/subscription-form** to receive regular email updates when we publish new draft items for comment.

Your opportunity to comment

Ref	Draft type	Title	Comment deadline
PUB00464	Interpretation guideline	Deductibility of software as a service (SaaS) configuration and customisation costs	3 May 2023
PUB00441	Interpretation statement	The interest limitation rules and short-stay accommodation	16 May 2023
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LEGISLATION AND DETERMINATIONS

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

EE004: Tax treatment of reimbursing payments made to employees who work from home and/or payments made for an employee's use of personal telecommunications tools and/or usage plans in their employment

Issued: 27 March 2023

Application

This determination applies to relevant payments made by employers from 1 April 2023.

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

From 1 April 2023, this determination replaces:

- Determination EE003: Payments provided to employees that work from home; employee use of telecommunications tools and usage plans in their employment", *Tax Information Bulletin* Vol 33, No 9 (October 2021): 35.

Background

1. Amounts an employer pays to an employee to reimburse that employee for costs they incurred in connection with their employment are taxable in the employee's hands unless the payment is exempted by the provisions of s CW 17.
2. Under s CW 17(2), a reimbursing payment is treated as exempt income to the extent that it meets two tests. The payment must:
   - be paid to the employee in connection with an employees' employment; and
   - be of a kind that would be ordinarily deductible to an employee if the employment limitation did not apply.
3. Section CW (2B) only treats expenditure as having been incurred **in connection with an employee's employment** when the:
   - expenditure is incurred or paid because the employee is performing an obligation required by their employment;
   - employee is deriving employment income from performing that obligation; and
   - expenditure is necessary to perform that obligation.
4. The first test at s CW 17(2) requires that expenditure being reimbursed must be of a kind that, if it were not for the employment limitation in s DA 2(4), it would be ordinarily deductible by the employee. Therefore, the expenditure in question must be deductible, under the general permission in s DA 1(1)(a): the employee must incur the expenditure in gaining their assessable income.
5. The general permission is subject to a number of general limitations. The effect of two of these limitations, the capital and private limitations, is to render both capital and private expenditure non-deductible. Consequently, if these types of expenditure are reimbursed, that reimbursement cannot be treated as exempt income[1] as the expenditure is not **ordinarily deductible** as required by s CW 17.

1 For the purposes of s CW 17, a depreciation loss is treated as an item of expenditure (s CW 17(4)).

6. The second test at s CW 17(2) requires the expenditure to be *incurred or paid in connection with the employee's employment.* As explained at [3], meeting this test requires that the expenditure meet the specific requirements of s CW 17(2B). It requires (amongst other things) that the expenditure is incurred or paid because the employee is performing an obligation required by their employment. It is the Commissioner's view that expenditure that is ordinarily incurred by an employee in their personal capacity cannot meet this test. To be recognised as exempt income, the expenditure reimbursed must be additional to any expenditure that may be ordinarily incurred by the employee in their personal capacity. This additional expenditure must be *incurred or paid in connection with the employee's employment.*
7. This means that any amounts reimbursed for an employee's non-variable personal expenditure (such as rent, rates and mortgage interest) could not be recognised as an exempt payment in the hands of an employee. This is because as well as being expenditure of a private nature, the quantum of the expenses do not vary depending on whether the employee works from home. There is no "additional" element to this type of expenditure that could be said to be *incurred or paid in connection with the employee's employment*.
8. The types of expenditure that would meet the tests set out above are generally limited to variable "utilities" costs. Electricity, gas, telephone, and internet charges. In addition, some small amounts of plant and equipment depreciation may also be deductible, on office equipment for example.
9. Given the complexity of these tests, employers may find it administratively difficult to establish the extent to which expenditure is incurred by employees in connection with their employment income or is of a private or capital nature. Employers may also find it difficult to establish, or realistically estimate, the expenditure that each employee may have incurred.
10. To reduce this difficulty and the subsequent compliance costs for employers, the Commissioner has published several determinations that deal with the treatment of this additional expenditure. The most recent of these determinations is "Determination EE003: Payments provided to employees that work from home; employee use of telecommunications tools and usage plans in their employment", *Tax Information Bulletin Vol 33, No 9 (October 2021): 35.*
11. The end date for Determination EE003 is 31 March 2023. Given this, the Commissioner has decided to issue this current determination, which extends the effect of the previous determination and does so without stipulating an end date. The Commissioner will continue to monitor the amount of variable expenditure employees typically incur and periodically update the amounts in this determination as well as reviewing the determination from time to time.
12. The amounts an employer may pay an employee as an exempt allowance from 1 April 2023 when that payment meets the requirements of s CW 17 are:
    - $20 per week to reimburse the employee for working from home ($15 per week in Determination EE003); and
    - $7 per week to reimburse the employee for use of personal telecommunications equipment or usage plans or both ($5 per week in Determination EE003).

Determination

13. This determination is made under s 91AAT of the Tax Administration Act 1994 and s CW17 (2C) and (2D). It applies to the following payments made by employers for the period from 1 April 2023.

This determination's requirements and exclusions

14. For this determination to apply:
    - an employer must make a payment to an employee;
    - the payment must be for an expenditure or loss incurred (or likely to be incurred) by the employee;
    - the expenditure or loss must be incurred by the employee in deriving their employment income and not be private or capital in nature (but noting that the capital limitation does not apply to an amount of depreciation loss);
    - the employee must derive employment income from performing their job;
    - where an employee is working in part from home and in part outside home, the home-based work must be more than minor (e.g., the determination can apply to an employee who works at the employer's premises on alternate days).

15. This determination does not apply to:
    - any payment already the subject of a payment as expenditure on account of an employee;[2]
    - any payments made for a period after an employee ceases to work from home (other than telecommunications payments made in accordance with [29]; and
    - an amount paid under a salary sacrifice arrangement.

This determination is not binding on employers or employees

16. This determination is not binding on employers or employees. An employer or employee may treat a different amount paid to the employee as exempt. However, they must be able to show that the amount treated as being exempt meets the requirements of s CW 17(2).

Weekly thresholds of this determination

17. Under this determination, where an employer pays an employee who is working from home an allowance or pays an allowance in respect of the employee's use of their personal telecommunications equipment[3] or usage plans or both, the most appropriate of the following options can be chosen and that amount treated as exempt income of the employee.

Where the employee works from home but does not use their own telecommunications tools or usage plans or both

18. Up to $20 per week of the amount the employer pays to reimburse their employee for additional expenditure incurred due to the employee working from the employee's home can be treated as exempt income of the employee. The same treatment can be applied to an equivalent amount paid for a different period, $40 per fortnight for instance.
19. The Commissioner considers this to be a *de minimis amount* that:
    - recognises any potential increase in household costs that an employee may incur when working from home;
    - recognises any amount of depreciation loss on existing depreciable assets (but see [39]–[50] in relation to newly acquired assets); but
    - excludes any reference to telecommunications tools or usage plans or both.

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

20. Where the employee works from home and uses their own telecommunications tools or usage plans or both for their employment, the employer and the employee may choose one of three options: the de minimis option, principally business use option or principally private use option.

De minimis option

21. Up to $27 per week of the amount the employer pays to reimburse their employee for additional expenditure incurred due to the employee working from the employee's home can be treated as exempt income of the employee. The same treatment can be applied to an equivalent amount paid for a different period, $54 per fortnight for instance.
22. The Commissioner considers this to be a *de minimis amount* that recognises any:
    - potential increase in household costs that an employee may incur when working from home (per [19]);
    - potential increase in telecommunications costs; and
    - amount of depreciation loss on existing depreciable telecommunications assets (but see [39]–[50] in relation to newly acquired assets).

Principally business use option

23. The principally business use option allows up to $20 per week of the amount paid to be treated as exempt income of the employee. The same treatment can be applied to an equivalent amount paid for a different period, $40 per fortnight for instance. This amount excludes any amount paid in relation to the use of the employee's telecommunications usage plans.

2 Section CW 17(1).

3 In this determination, the term *telecommunication equipment* means not only the principal telecommunication device (laptop, smartphone) but all peripheral equipment required to enable an employee to use that equipment for employment purposes. For the avoidance of doubt, this can include such equipment as power cords, mouse, keyboard, monitor and printer.

24. In addition to this $20, where the employee uses their personal telecommunications tools or usage plans or both principally for business purposes, employers can treat any reimbursement of up to 75% of the amount of the employee's total usage plan bill as exempt income of that employee. If the cost of the employee's usage plan is not a regular amount, then a reasonable estimate of the likely expenditure is acceptable. For further discussion about reasonable estimates, see [36]–[38].
25. An amount of depreciation loss on existing telecommunications assets the employee owns may also be paid using the Commissioner's depreciation rates for the item (but see [39]–[50] in relation to newly acquired assets).

Principally private use option

26. The principally private use option allows up to $20 per week of the amount to be treated as exempt income of the employee on the same basis as described at [19].
27. In addition to this $20, where the employee uses their personal telecommunications tools or usage plans or both principally for private purposes, employers can treat any reimbursement of up to 25% of the amount of the employee's total usage plan bill as exempt income of that employee. If the cost of the employee's usage plan is not a regular amount, then a reasonable estimate of the likely expenditure is acceptable. For further discussion about reasonable estimates, see [36]–[38].
28. An amount of depreciation loss on existing telecommunications assets the employee owns may also be paid using the Commissioner's depreciation rates for the item (but see [39]–[50] in relation to newly acquired assets).

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

29. Where an employee does not work from home but uses their own telecommunications tools or usage plans or both in the course of their employment, an employer may choose one of three options: the *de minimis* option, principally business use option or principally private use option.

De minimis option

30. The *de minimis* option allows up to $7 per week of the amount paid to be treated as exempt income of the employee. The same treatment can be applied to an equivalent amount paid for a different time-period, $14 per fortnight for instance. The Commissioner considers that this *de minimis* amount recognises all costs an employee might incur, including any amount of depreciation loss on existing depreciable telecommunications assets that the employee may use (but see [39]–[50] in relation to newly acquired assets).

Principally business use option

31. Under the principally business use option, employers can treat any reimbursement of up to 75% of the amount of the employee's total usage plan bill as exempt income of the employee (as per [24]). If the cost of the employee's usage plan is not a regular amount, then a reasonable estimate of the likely expenditure is acceptable. For further discussion about reasonable estimates, see [36]–[38].
32. An amount of depreciation loss on existing telecommunications assets that are owned by the employee may also be paid using the Commissioner's depreciation rates for the item (but see [39]–[50] in relation to newly acquired assets).

Principally private use option

33. Under the principally private use option, employers can treat any reimbursement of up to 25% of the amount of the employee's total usage plan bill as exempt income of that employee (as per [27]). If the cost of the employee's usage plan is not a regular amount, then a reasonable estimate of the likely expenditure is acceptable. For further discussion about reasonable estimates, see [36]–[38].
34. An amount of depreciation loss on existing telecommunications assets that are owned by the employee may also be paid using the Commissioner's depreciation rates for the item (but see [39]–[50] in relation to newly acquired assets).
35. This determination does not apply where the employer provides the telecommunications tool and pays for usage. In such circumstances, there may be fringe benefit tax implications. Note that s CX 21 provides an exemption for business tools.

Reasonable estimate to be made

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

37. However, it may be difficult to determine the level of use precisely, so this determination allows for less than precise estimation. The employer may, for instance, rely on evidence of time spent to show the asset is used principally for business purposes. However, the employer may instead choose to obtain a signed declaration from an employee that telecommunications tools will be used principally for employment purposes.
38. The employer should periodically review the apportionment used to check the level of use remains consistent. A review once every two years is adequate. If an employer has obtained a signed declaration from an employee that telecommunications tools will be principally used for employment purposes, then a review is required only if the employee's circumstances have materially changed.

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

39. The Commissioner recognises that the employee may need to acquire personal home office telecommunications equipment or furniture and other equipment to enable them to work effectively at home. Where assets are acquired for this purpose, an employee will incur a depreciation loss that the employee can claim as a deduction, but for the employment limitation.[4]
40. Because of the low-value asset rule, for many assets the depreciation loss is likely to be equal to the cost of the asset.[5]
41. Where an employer wishes to reimburse the employee for the cost they incurred in acquiring their home office furniture or equipment, this determination provides they can use the:
    - safe harbour option for telecommunications equipment and a separate safe harbour option for furniture and other equipment; or
    - reimbursement option.

Safe harbour option

42. Under the safe harbour option, an employer can treat payments of up to $400 made to reimburse the employee for the costs incurred in acquiring new telecommunications equipment as exempt income. Additionally, they may also treat payments of up to $400 made to reimburse the employee for the costs incurred in acquiring new furniture and other equipment as exempt income. Each $400 limit applies to the costs of **all** furniture and other equipment and **all** telecommunications equipment the employee acquires. The limit is not an item-by-item limit.
43. The safe harbour option saves an employer from having to identify the costs their employees have incurred (or are likely to incur) and to judge the extent to which the furniture or equipment is used by employees for their employment.
44. If an employer adopts the safe harbour option, they cannot treat any future allowance or reimbursement payment for any subsequent telecommunications equipment or furniture or other equipment purchases made by the employee as exempt income. It is not an amount that refreshes on a regular basis, annually for instance.

Reimbursement option

45. Under the reimbursement option, an amount an employer pays is exempt income of an employee if the amount is:
    - for telecommunications equipment or furniture or other equipment purchased by the employee to enable them to work from home; and
    - no more than the deduction the employee would have been entitled to for depreciation loss on the furniture or equipment (or the cost of the asset in the case of low-value assets) for the income year in which the payment is made, but for the employment limitation.
46. The deduction the employee would have been entitled to for an asset, so the amount that can be paid as exempt income, depends on the extent to which the employee uses the asset for their employment. This means the amount that can be paid as exempt income will be equal to a proportion of the yearly depreciation loss on the asset (or a proportion of the cost of the asset in the case of a low-value asset).

4 To the extent that an employee incurs a depreciation loss on existing furniture or equipment, this loss is included in the exempt income thresholds.

5 The threshold for low-value assets purchased before 17 March 2020 is $500. For assets purchased on or after 17 March 2020 and before 17 March 2021, the threshold is $5,000. From 17 March 2021, the threshold decreased to $1,000.

47. Where evidence exists that an asset will be used exclusively for employment purposes, 100% of the yearly depreciation loss on the asset (or the total cost of the asset in the case of a low-value asset) can be paid as exempt income of the employee. Further, under this determination where an employee uses an asset:
    - principally for their employment, an amount of no more than 75%[6] of the yearly depreciation loss on the asset (or the cost of the asset in the case of a low-value asset) can be paid as exempt income of the employee; and
    - principally for private use, an amount of no more than 25% of the yearly depreciation loss on the asset (or the cost of the asset in the case of a low-value asset) can be paid as exempt income of the employee.
48. The reimbursement option requires an employer to identify the cost of the asset for which the reimbursement is paid as well as to determine whether the asset is being used exclusively or principally for employment purposes or principally for private purposes (so they can calculate the appropriate proportion). For assets that are not low-value assets (which are likely to be uncommon), the employer also needs to apply the relevant depreciation rate to calculate the depreciation loss that would have been available to the employee.
49. The reimbursement option may be onerous to use in cases such as where an employer has many employees. That is why the safe harbour option has also been allowed.
50. A written statement from an employee to their employer that the employee intends to use an asset for their employment, whether principally or not, is sufficient to establish such use. An email or expense claim application is sufficient to show the employee's intended use of the furniture or equipment.

This determination was signed by me on 27 March 2023.

Rob Falk

Technical Lead, Technical Standards, Legal Services

Inland Revenue

References

Legislative references

Income Tax Act 2067, ss CW 7, CW 17, CX 21, DA 1, DA 2

Tax Administration Act 1994, s 91AAT

Other references

"Determination EE003: Payments provided to employees that work from home; employee use of telecommunications tools and usage plans in their employment", *Tax Information Bulletin* Vol 33, No 9 (October 2021): 35

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

DET 23/01: Amortisation Rates for Landfill Cell Construction Expenditure

Application

This Determination sets out the amortisation rates for landfill cell construction expenditure as determined by the Commissioner of Inland Revenue. It is made pursuant to section 91AAN of the Tax Administration Act 1994.

The Determination applies to taxpayers, who meet the criteria under section DB 46 of the Income Tax Act 2007 and have incurred landfill cell construction expenditure in an income year starting on or after 1 April 2022. Its application may be supplemented or amended by supplementary Determinations pursuant to section 91AAN(6) of the Tax Administration Act 1994.

REPLACES DET 05/02, which was issued 15 November 2005.

Discussion

In this Determination, unless the context otherwise requires, expressions used have the same meanings as those in ss CB 8, CB 28, DB 46, YA 1, schedules 12 and 19 of the Income Tax Act 2007 and s 91AAN of the Tax Administration Act 1994 in respect of an income year starting on or after 1 April 2022 and subsequent income years.

Determination

Pursuant to section 91AAN of the Tax Administration 1994, for the purposes of section 91AAN(2), the banded rate set out in schedule 12 of the Income Tax Act 2007 that is to be used to amortise the types of landfill cell construction expenditure, as set out in the schedule to this Determination and incurred in an income year starting on or after 1 April 2022, shall be, at the election of the taxpayer, at either:

a. 63.5% (straight-line equivalent); or
b. 63.5% (diminishing value depreciation rate

This Determination is made by me, acting under delegated authority from the Commissioner of Inland Revenue under section 7 of the Tax Administration Act 1994.

This determination was signed by me on 7th March 2023.

Rob Falk

Technical Lead, Technical Standards, Legal Services

Inland Revenue

SCHEDULE TO DETERMINATION DET 23/01
AMORTISATION RATES FOR LANDFILL CELL CONSTRUCTION EXPENDITURE

Types of landfill cell construction expenditure to which this Determination shall apply
Cell construction costs
Excavation means costs relating to: • Earthworks design • Preparatory works (such as clearing the cell site) • Earthworks, including excavation, borrowing and filling • Erosion control measures and remediation of borrowed areas associated with cell construction • Contractors' overheads related to cell construction • Cell-specific resource consents other than those which qualify as fixed life intangible property.
Cell lining means costs relating to the design, construction and quality assurance of cell liners (clay, geosynthetic, flexible membrane, concrete or bitumen) and protection and separation layers, including reworking and sub-excavation to support subsequent compaction or to provide slope stability.
Leachate drainage means the provision of drainage material to assist in drainage of leachate from the base and sidewalls of a landfill cell. This excludes drainage pipes and systems for the passage and extraction of leachate from the landfill.

Note: The above landfill cell construction expenditure does not include expenditure that relates to the site development of the landfill and expenditure that is deductible under any legislative provision in the Income Tax Act 2007 other than section DB 46.

COMMENTARY ON DETERMINATION DET 23/01
AMORTISATION RATES FOR LANDFILL CELL CONSTRUCTION EXPENDITURE

Introduction

This commentary does not form part of the Determination. It is intended to help in the understanding and application of the Determination.

This Determination sets out the amortisation rates (depreciation like deductions) that the Commissioner has determined for each of the types of landfill cell construction expenditure that is listed in the schedule to this Determination (later referred to as "listed landfill cell construction expenditure").

Taxpayers who meet the criteria under section DB 46 of the Income Tax Act 2007 and have incurred the listed landfill cell construction expenditure in an income year starting on or after 1 April 2022, are required to elect to apply either the amortisation rate of 63.5% (diminishing value depreciation rate) or 63.5% (straight-line equivalent).

This Determination does not apply to types of expenditure that are not listed in the schedule to this Determination.

Criteria under section DB 46 of the Income Tax Act 2007

A taxpayer meets the criteria under section DB 46 of the Income Tax Act 2007 if:

- the taxpayer carries on a business in New Zealand; and
- the taxpayer incurs, in the business, expenditure:
  - that is of a type listed in schedule 19 of the Income Tax Act 2007, other than expenditure listed in part C of the schedule; and
  - that is not incurred in relation to revenue account property other than land that is subject to section CB 8 of the Income Tax Act 2007; and
  - that is not deductible under any other legislative provision in the Income Tax Act 2007 but for section DB 46.

Estimated useful life

The amortisation rate for listed landfill cell construction expenditure is based on:

- the average planned filling time for commercial landfill cells in New Zealand; and
- the average estimated economic life of commercial landfill cells in New Zealand.

Commercial landfill cells refer to landfill cells that are constructed by taxpayers in the waste management industry who meet the above criteria under section DB 46 of the Income Tax Act 2007.

For the listed landfill cell construction expenditure, the estimated useful life commences once construction of the commercial landfill cell to which the expenditure relates has been completed and continues until the relevant landfill cell is filled and capped.

The average planned filling time of commercial landfill cells in New Zealand is approximately one year. For the purpose of calculating the estimated useful life of commercial landfill cells, this is the main factor that has been considered in estimating the economic life of these cells.

The practice of intermediate filling affects the estimated economic life of commercial landfill cells. Intermediate filling refers to situations where a commercial landfill cell can only be filled to a certain level of the cell's capacity in the first year of operation. Intermediate filling may occur due to the size and/or depth of the landfill cell, topographical or other operational factors. Where intermediate filling is involved, the commercial landfill cell will have an estimated economic life longer than the planned filling time of one year.

Inland Revenue has considered the fact that even if intermediate filling is involved, most revenues will be derived from a commercial landfill cell in its first year of operation. Using a weighted-average, Inland Revenue generally has applied more weight to the first year of commercial landfill cell's operation as opposed to the later year(s) before the cells are fully filled and capped.

During the process of making this Determination, Inland Revenue has also considered the following matters, but decided that these matters do not significantly impact on the estimated useful life of a commercial landfill cell in New Zealand:

- future development in waste management technologies and initiatives; and
- landfill gas revenues derived from commercial landfill cells; and
- the likelihood of re-opening commercial landfill cells after they have been capped; and
- non-commercial landfills; and
- commercial landfills in overseas jurisdictions.

The estimated useful life of commercial landfill cells in this Determination has been established by Inland Revenue following extensive consultation with taxpayers in the waste management industry and industry experts.

Amortisation rates

The process adopted in arriving at the amortisation rates of the listed landfill cell construction expenditure commenced with the establishment of the estimated useful life for the commercial landfill cells. This data is then translated into an established straight- line equivalent rate as set out in column 2 of schedule 12 of the Income Tax Act 2007. The straight-line equivalent rate in column 2 is further translated into an appropriate diminishing value depreciation rate as set out in column 1 of schedule 12.

Although the estimated useful life of commercial landfill cells may vary in New Zealand, the amortisation rates of the listed landfill cell construction expenditure in this Determination have been established for the widest possible application to the waste management industry.

Application of this Determination to expenditure incurred in an income year starting on or after 1 April 2022

This Determination applies to taxpayers who meet the criteria under section DB 46 of the Income Tax Act 2007 and incur the listed landfill cell construction expenditure in an income year starting on or after 1 April 2022.

Where taxpayers have an approved non-standard balance date of 30 June, the Determination applies to the listed landfill cell construction expenditure incurred on or after 1 July 2022. The Determination shall not apply to these taxpayers before their 2022 income year.

Additions of new amortisation rates/amendments to existing amortisation rates

Amendments to this Determination will be made by the Commissioner issuing supplementary Determinations pursuant to subsection 91AAN(6) of the Tax Administration Act 1994.

Amendments may include adding further expenditure to those already listed in the schedule to this Determination, adjusting the estimated useful life of commercial landfill cells due to operational changes in the waste management industry in New Zealand. Amendments may be effective for the current or future income years. They will not apply to previous income years.

Changes may also be made to the Determination from time to time by Inland Revenue on receipt of written applications from taxpayers in the waste management industry.

Applications for changes must include the following information:

- the nature of the amendment to the Determination being sought; and
- applicant's details - this includes full name, IRD number (if applicable), address, and contact details (i.e. cell phone number and the contact person) for enquiries; and
- information to support the change requested.

Applications for changes to the Determination are to be sent to:

Technical Lead
Technical Standards, Legal Services
Inland Revenue
P O Box 2198
WELLINGTON

In considering applications for amendment to this Determination, Inland Revenue will continue to consult with relevant taxpayers in the waste management industry and industry experts.

Inland Revenue will discuss any amendment that is to be made to this Determination with the applicant before it is finalised.

AE 23/01: Participating jurisdictions for the CRS applied standard

Determination

New Zealand's list of participating jurisdictions made by determination under section 91AAU of the Tax Administration Act 1994 for the purposes of the CRS applied standard and associated requirements under Part 11B of the Tax Administration Act 1994 has been amended with effect from the 1st of April 2023 as follows:

Jurisdictions added to the participating jurisdictions list

Jamaica	Marshall Islands	Niue

Full list of participating jurisdictions from 1 April 2023

Albania	Andorra	Anguilla	Antigua and Barbuda
Argentina	Aruba	Australia	Austria
Azerbaijan	Bahamas	Bahrain	Barbados
Belgium	Belize	Bermuda	Brazil
British Virgin Islands	Brunei	Bulgaria	Canada
Cayman Islands	Chile	China	Colombia
Cook Islands	Costa Rica	Croatia	Curaçao
Cyprus	Czech Republic	Denmark	Dominica
Ecuador	Estonia	Faroe Islands	Finland
France	Germany	Ghana	Gibraltar
Greece	Greenland	Grenada	Guernsey
Hong Kong	Hungary	Iceland	India
Indonesia	Ireland	Isle of Man	Israel
Italy	Japan	Jamaica	Jersey
Kazakhstan	Korea	Kuwait	Latvia
Lebanon	Liechtenstein	Lithuania	Luxembourg
Macao	Malaysia	Malta	Marshall Islands
Mauritius	Mexico	Monaco	Montserrat
Nauru	Netherlands	New Caledonia	New Zealand
Nigeria	Niue	Norway	Oman
Pakistan	Panama	Peru	Poland
Portugal	Qatar	Romania	Russia

Saint Kitts and Nevis	Saint Lucia	Saint Vincent and the Grenadines	Samoa
San Marino	Saudi Arabia	Seychelles	Singapore
Slovak Republic	Slovenia	South Africa	Spain
Sweden	Switzerland	Turkey	Turks and Caicos Islands
United Arab Emirates	United Kingdom	Uruguay	Vanuatu

Dated at Wellington on the 8th day of February 2023

John Nash

Strategic Advisor, International Revenue Strategy

Inland Revenue

References

Legislative references

Tax Administration Act 1994: s 91AAU

QUESTIONS WE'VE BEEN ASKED

This section of the *TIB* sets out the answers to some day-to-day questions people have asked. They are published here as they may be of general interest to readers.

QB 23/03: Income Tax – Donation tax credits and payments made by parents to childcare centres

Question

When will a parent's payment to their child's childcare centre qualify for a donation tax credit?

Answer

Payments parents make to childcare centres are gifts for donation tax credit purposes where:

- **the childcare centre is a donee organisation;**
- **the payment is money of $5 or more;**
- **the parent makes the payment voluntarily to benefit the centre either generally or for a specific purpose or project; and**
- **the parent or child gains no material benefit or advantage in return for making the payment.**

Key terms

Parent includes a child's guardian or caregiver who makes payments to a childcare centre.

Childcare centre includes kindergartens, daycare centres, preschools, early learning centres, crèches, kōhanga reo, Pacific Island language centres, Playcentres, playgroups and the like. It does not include home-based carers or early learning services provided by in-home educators.

Explanation

1. The Commissioner has been asked to clarify when payments parents make to childcare centres will qualify for a donation tax credit. (QB 23/04: Goods and Services Tax – Payments made by parents to childcare centres[1] clarifies the GST treatment of payments parents make to childcare centres.)
2. In the past some parents have made payments incorrectly called "donations" to childcare centres in substitution for paying no or low childcare fees. The Commissioner's view on this practice was addressed in Revenue Alert 14/01.[2] There are no donation tax credits for any payments paid by parents to childcare centres incorrectly described as "donations".

How are childcare centres funded?

3. Before considering whether a payment a parent makes to a childcare centre is eligible for a donation tax credit, it is helpful to understand the government's role in funding childcare centres, as this helps with understanding the types of payments childcare centres may ask parents to make.
4. The Early Childhood Education (ECE) Funding Subsidy is the primary form of government funding paid to childcare centres that are licensed as ECE service providers under the Education and Training Act 2020. According to Ministry of Education guidelines in *ECE Funding Handbook*,[3] the ECE Funding Subsidy is a contribution to a centre's operating costs, paying for part of each hour each child spends in early childhood education, to a maximum of 6 hours per child-place per day (that is, 30 hours per child-place per week). The subsidy is available for any enrolled children aged up to 6 years.

1 Inland Revenue, 2023.

2 *Tax Information Bulletin* Vol 26, No 6 (July 2014): 4.

3 Ministry of Education, no date, issued under s 548(5) of the Education and Training Act 2020.

5. Licensed childcare centres that provide ECE services to children aged 3 to 5 years can obtain a higher rate of funding, up to a maximum of 6 hours per child per day and 20 hours per week. This is referred to as "20 Hours ECE". A centre can choose whether to offer parents 20 Hours ECE. Those centres that offer 20 Hours ECE may also claim the ECE Funding Subsidy for any additional hours a child attends over the hours covered by 20 Hours ECE, up to the maximum of 6 hours per day/30 hours per week.
6. According to the *ECE Funding Handbook*, childcare centres cannot charge parents fees for hours claimed as 20 Hours ECE. Parents may be charged fees for attendance hours outside of the hours claimed as 20 Hours ECE per week.
7. Where preschool children need additional hours of care in excess of 20 Hours ECE or are too young to access the 20 Hours ECE (that is, the child is younger than 3 years) some families may qualify for assistance like the Work and Income Childcare Subsidy or Early Learning Payment.
8. Both the ECE Funding Subsidy and the Work and Income payments are paid directly to the childcare centre and not to the parents. While the funding assists families with their childcare costs, the payments are not taxable income of the parents and do not affect a parent's Working for Families tax credit entitlement.

What types of payments do parents make to childcare centres?

9. Despite receiving some government funding many childcare centres will also charge parents fees for attendance and other things. The amount of fees charged, or whether fees are charged, will usually depend on the type of childcare centre (for example, whether it is a private "for-profit" childcare centre or a community-based, parent-led not-for-profit organisation).

Fees

10. Subject to the rules relating to 20 Hours ECE (see [6]), a childcare centre can charge fees for a child's attendance at the centre. This includes those childcare centres known as "free kindergartens" (see s 26 of the Education and Training Act 2020).
11. Where a childcare centre charges fees for a child's attendance at the centre, a contractual relationship exists between the centre and the parents for the provision of ECE services in return for the payment of fees. Donation tax credits are not available for any attendance fees parents pay to childcare centres.

Optional charges

12. Childcare centres can charge parents for optional activities or goods. These are things a parent purchases from a centre in addition to or to supplement the ECE services the childcare centre provides. The parent can choose whether to purchase the goods or services. No donation tax credits are available for any charges parents agree to pay to childcare centres in return for the optional activities or goods.
13. The *ECE Funding Handbook* includes information on the optional charges that licensed childcare centres can request, a list of unacceptable charges, and the level of service that must be provided to a parent who chooses not to pay optional charges. Acceptable optional charges include charges for transport, sunscreen, music teachers and sunhats. Unacceptable optional charges include contributions towards the cost of high-quality education, premiums for being a well-regarded service, and administration of 20 Hours ECE. Childcare centres that do not offer 20 Hours ECE are not subject to these rules.

Donations, koha and voluntary contributions

14. Parents may choose or be asked to make donations, pay koha or make voluntary contributions to childcare centres. This is more likely to occur in respect of community-based centres such as free kindergartens, kōhanga reo, Playcentres and playgroups. However, it is possible (although less likely) that private for-profit childcare centres may also receive donations, koha or voluntary contributions from parents.
15. Where the centre is a donee organisation, and the donation, koha or voluntary contribution is a "charitable or public benefit gift" (as defined in s LD 3), then parents may be entitled to a donation tax credit under s LD 1 for the donation, koha or voluntary contribution.

What is a donation tax credit?

16. A donation tax credit is a refundable tax credit available for charitable or other public benefit gifts that an individual makes to a donee organisation where the requirements in ss LD 1 to LD 3 are met.

17. An individual can claim a donation tax credit of one-third of the payment amount. An individual's claim for a donation tax credit must be supported by appropriate donation receipts from the donee organisation. The Commissioner reviews an individual's claim, then notifies the individual of the amount of tax credit that will be allowed.
18. The sum of charitable or other public benefit gifts an individual taxpayer makes in a tax year must not exceed their taxable income for that year. Therefore, the Commissioner will reduce the donation tax credits for gifts an individual makes in a tax year, if, in total, the credits claimed exceed the individual's taxable income for that year (see s 41A(3) and (4) of the Tax Administration Act 1994).

When are donation tax credits available for parents' payments?

19. Donation tax credits are available for payments of money of $5 or more that a parent makes to a childcare centre only where they satisfy the requirements in ss LD 1 to LD 3. That is, donation tax credits are available where:
    - the childcare centre is a "donee organisation"; and
    - the payment is "a charitable or other public benefit gift".

What childcare centres are donee organisations?

20. Childcare centres can be run in different ways and for different purposes. This can affect whether a centre qualifies as a donee organisation. For example, a childcare centre might be a private for-profit business or it might be a community-based, not-for-profit organisation.
21. Donation tax credits can be claimed for gifts parents make to only childcare centres that are donee organisations:
    - Childcare centres operated by private for-profit organisations are not donee organisations, so donations parents make to those centres will never qualify for donation tax credits.
    - The Commissioner automatically recognises childcare centres operated by charitable organisations registered under the Charities Act 2005 as being donee organisations. From 1 April 2020, all entities with charitable purposes that qualify for registration under the Charities Act are required to be registered with the Charities Service of the Department of Internal Affairs to qualify as donee organisations. The advancement of education is included as a charitable purpose.
    - Childcare centres operated by other types of non-profit organisations need to have obtained approved donee status from the Commissioner to be recognised as donee organisations. Generally, a childcare centre that is not a charitable organisation may qualify as a donee organisation if it applies its funds wholly or mainly to benevolent, philanthropic or cultural purposes within New Zealand.
22. For additional guidance on donee organisations, see OS 22/04: Charities and Donee Organisations - Part 2 Donee Organisations.[4]

When are payments to a childcare centre charitable or other public benefit gifts?

23. The second requirement for donation tax credits is that a payment made by a parent to a childcare centre that is a donee organisation is a charitable or other public benefit gift.
24. The phrase "charitable or other public benefit gift" specifically excludes gifts made by will and forgiveness of debt. However, the word "gift" is not defined in the Income Tax Act 2007. Aotearoa New Zealand courts say the meaning of "gifting" and "gift" is to be determined by reference to the text and purpose of the legislation (in this case, ss LD 1 to LD 3). That meaning is then to be applied by considering all of the arrangements that were actually entered into and carried out.[5]
25. In the absence of a statutory definition of the word gift, the courts agree that for donation tax credit purposes the word should be given its ordinary and natural meaning.[6]

4 *Tax Information Bulletin Vol 34*, No 10 (November 2022): 44.

5 *Church of Jesus Christ of Latter-Day Saints Trust Board and Coward v CIR* [2020] NZCA 143 at [28].

6 For example, *Chief Executive of Ministry of Social Development v Broadbent* [2019] NZCA 201 at [80], *Church of Jesus Christ of Latter-Day Saints Trust Board* at [55] and *FTC v McPhail (1968)* 117 CLR 111 (HCA) at 116.

26. Based on case law, and taking into account s LD 3(1) in the light of its purpose and its context,[7] the Commissioner considers the ordinary and natural meaning of the word gift is a payment of money of $5 or more:
    - made voluntarily;
    - made by way of benefaction (that is, made to benefit the donee organisation); and
    - where the payer receives no material benefit or advantage in return.

Payment is made voluntarily

27. To qualify as a gift, a payment by a parent to a childcare centre must be made voluntarily. For gifting purposes, this means the payment is made willingly and freely by choice.
28. As a rule, a payment will not be made voluntarily if it is made under a contract or required to be made under some statutory or other legal obligation.[8]
29. However, the absence of a contract or a legal obligation on a parent to contribute to a centre does not automatically mean payments are voluntary. There can be circumstances where, even though a parent has no legal obligation to make a payment to a childcare centre, the payment still will not be considered "voluntary" for donation tax credit purposes.
30. For example, in *FCT v McPhail*,[9] the High Court of Australia found that contributions a parent made to a school building fund in return for reduced school fees were not gifts. In part, this was because the parent's agreement to contribute to the fund placed an obligation on the school to provide education facilities for the reduced fee. As a result, the court found the contribution to the building fund was not a voluntary payment. Furthermore, it found the parent made the payment in the expectation that in return they would receive, and did in fact receive, a substantial concession in the fees charged for the education of their son.
31. Occasionally, a childcare centre or other parents may put pressure on a parent to make a payment, and this can create a sense of moral obligation on the parent. A payment made under a sense of moral obligation is still voluntary. However, in some circumstances, pressure might also be evidence that a payment is being made under an arrangement between the centre and the parent. If an objective analysis of the legal arrangements governing the payment and the surrounding circumstances establishes that the payment is not, in fact, voluntary, then it will not be a gift.

Payment benefits the childcare centre

32. The Commissioner considers case law supports benefaction being an element of a gift in the context of donation tax credits.[10] Benefaction is the idea that a gift should provide an advantage or benefit to the donee organisation. While the Court of Appeal did not discuss the idea of benefaction in *Church of Jesus Christ of Latter-Day Saints Trust Board*[11] or refer to *Leary*,[12] in the Commissioner's view this should not be taken as meaning a court considering a different set of facts would not see benefaction as being an attribute of a gift for the purposes of s LD 1. Its presence demonstrates that a payment is made to advantage the donee organisation.
33. A payment made without benefaction will not be a gift in the ordinary sense of the word. For example, benefaction will not ordinarily be present where a donor's payment places a "countervailing material detriment"[13] on the donee organisation so that the organisation is prevented from benefiting (in whole or in part) from the payment.
34. In *Case J76*[14] a priest made payments to schools to ensure disadvantaged children in his parish could access appropriate schooling. The priest argued his payments were gifts, so he was entitled to the equivalent of a donation tax credit. Judge Keane found there was no doubt that the payments were made out of charity, but the payments placed the schools under a contractual duty to educate the children and were made in return for the schools' educational services. The priest's payments were not gifts to the schools, so no donation tax credit equivalent was allowed.

7 Section 10(1) of the Legislation Act 2019.

8 *Leary v FCT* 80 ATC 4,438 (FCA) per Bowen CJ.

9 (1968) 117 CLR 111 (HCA).

10 The Australian Federal Court in *Leary* found benefaction to be an essential idea of a gift, in its ordinary sense.

11 *Church of Jesus Christ of Latter-Day Saints Trust Board and Coward v CIR* [2020] NZCA 143.

12 80 ATC 4,438 (FCA).

13 Deane J in *Leary* at 4,453 stated, "It involves, in my view, the concept that the relevant transfer is by way of well doing in that the recipient will be advantaged, in a material sense and without any countervailing material detriment arising from the circumstances of the transfer, to the extent of the property transferred to him".

14 (1987) 9 NZTC 1,451.

35. To the Commissioner, benefaction is another measure for determining whether a payment is a gift for donation tax credit purposes (along with whether the donor makes the payment voluntarily and gains a material benefit in return for making the payment). If, following an objective analysis of the legal arrangements governing the payment and the surrounding circumstances, benefaction cannot be established, then the payment will not be a gift for donation tax credit purposes.
36. Such an interpretation of the word gift is consistent with the policy underlying the donation tax credit rules: that donation tax credits are available "to encourage New Zealand taxpayers to provide financial support to charities".[15] For example, if by receiving a payment, the childcare centre is placed under a countervailing obligation so the centre gains no advantage or benefit from the payment, then the Commissioner considers the payment is not truly a gift in the ordinary and natural meaning of the word.

No material benefit or advantage in return

37. A payment to a childcare centre will not usually be a gift in circumstances where the payment results in a material benefit or advantage being conferred in return. For example, where payment is a requirement of attendance at a childcare centre then that payment is treated as a fee for tax purposes, and not a gift (even if the childcare centre does not refer to the payment as a fee).
38. The material benefit or advantage does not need to come directly from the centre. It also does not need to be received directly by the parent who made the payment (for example, their child may receive an education benefit).
39. A benefit or advantage will be considered "material" if it is of substance and can be valued or owned or both. For example, if the centre's newsletter advertises a parent's business in return for the parent making the payment, that would be a material benefit.
40. A benefit or advantage will not be material if it is intangible and cannot be valued or owned. An example of a non-material benefit or advantage is public acknowledgement, such as printing a parent's name in a centre newsletter to acknowledge their gift.
41. Importantly, not every material benefit or advantage will necessarily disqualify a voluntary payment to a childcare centre from being a gift. To disqualify a voluntary payment to a childcare centre from being a gift, the benefit or advantage needs to arise **in return for** the payment. The extent and strength of any connection between the parent's payment and a benefit or advantage is an important factor in determining whether a payment is a gift.
42. For example, sometimes a centre may want to thank its parents and acknowledge their generosity by inviting them to a function or giving them a token of appreciation. In those situations, the benefit, even if material, does not disqualify a parent's payment from being a gift. This is because the parent had no expectation of being invited to the function when making the payment, so the link between the payment and the benefit is insufficient.
43. The Court of Appeal considered the strength of the link between a parent's payment and an education benefit or advantage in *Church of Jesus Christ of Latter-Day Saints Trust Board*. On the facts in that case, the court concluded an insufficient connection existed between the parent's payments to the church and any potential material benefit the parent's child received when they were acting as a missionary overseas. However, the court noted that the facts in this case were quite different from the "education benefit" cases[16]they had been referred to.[17] In the "education benefit" cases, students received the clearly material benefit of an education and the parents gained the benefit of paying reduced or no fees for the education provided.
44. For example, in the Canadian decision *R v Coleman,*[18] families made voluntary non-refundable payments to a religious charity and in return financial benefits were made available to students from those families to help with the cost of their education. The court found the payments were not gifts because they had a strong link to the financial benefits to the families. The voluntary payments relieved the families from having to pay education costs.
45. The court determined the strength of the link by looking at a variety of factors objectively, weighing them and applying them in a common-sense way. The factors included the relationship between the parties, the correlation between the amounts paid and the value of the benefit gained, and the circumstances surrounding the payment.

15 *Church of Jesus Christ of Latter-Day Saints Trust Board* at [56].
16 *McPhail, R v Zandstra* [1974] 2 FC 254 (Canada); *R v Coleman* (2010) TTC 109 (Canada); *Winters v CIR* 468 F 2d 778 (2nd Cir 1972) (US).
17 *Church of Jesus Christ of Latter-Day Saints Trust Board* at [61].
18 (2010) TTC 109.

46. In *Case 8/2018* (2018) 28 NZTC 4,015 (TRA), a GST decision, the issue was whether amounts paid by the parents of children attending a private school were consideration for a supply of education services or unconditional gifts. Judge Sinclair found on the facts that while children could not be excluded from attending the school if their parents were unable to pay, the school was still "dependent" on parents' contributions. It was evident from the background facts, including the related documentation and correspondence between the school and the parents, that if the parents had not made the contributions, the school would not have been able to operate. For this reason, Judge Sinclair found that in the circumstances a sufficient link could be established between the parents' contributions and the supply of education services by the school, so the parents' contributions were made for the supply of education services and were not unconditional gifts.

47. While *Case 8/2018* relates to GST, so is of only limited relevance in the context of donation tax credits, it is an example of a situation where a court determined, after taking into account all the circumstances surrounding the payments made by the parents, that a sufficient link existed between the parents' payments and the material benefit of an education for reduced or no fees.

Are koha eligible for donation tax credits?

48. Sometimes, childcare centres might request koha. Koha might be money, parent help or goods. Koha might be paid in addition to fees or other charges or instead of fees. Donation tax credits are available only for koha that are gifts of money and meet the requirements of a gift (see [26]). Other forms of koha (such as parent help or goods) are not eligible for donation tax credits. In addition, to be eligible for donation tax credits the childcare centre must be an approved donee organisation.

Can a gift be for a specific purpose?

49. Sometimes gifts will be made to a childcare centre for a specific purpose or project, for example, to build a new playground. The fact a centre seeks donations for a specific project does not, in itself, prevent the payment from being a gift. In the Commissioner's view, a gift made for a specific purpose will not cease to be a gift so long as no material benefit or advantage is provided in return for the payment.

50. Further, the fact a parent's child may be among those who ultimately benefit from a community project will not usually disqualify the payment from being a gift. However, the stronger the connection between a parent's payment and any material benefit or advantage they gain in return, the less likely it is that the payment will qualify as a gift.

Can part of a payment be a gift?

51. The legal arrangements that the parties enter into and carry out and the surrounding circumstances establish the nature of the transaction. It is not open to parents and childcare centres to later choose to describe a payment as comprising two separate payments – one for consideration (for example, a sale) and one made voluntarily for no consideration (that is, a gift) – if, in fact, it was a single transaction. For example, if the price paid for an item at a charity auction to raise funds for the centre exceeds the value of the item, the centre cannot treat the amount paid above its value as a gift. It may not issue a donation receipt in that situation.

52. However, a childcare centre may be able to issue a donation receipt where a parent makes two payments at the same time. For example, if a parent purchases tickets to an event the childcare centre is hosting and at the same time voluntarily supports the centre by making an additional payment, the additional voluntary payment may be a gift. For the additional payment to be a gift, the parent must be allowed to attend the event regardless of whether they make any additional payment; that is, the ticket purchase must not depend on the parent making an additional payment. In that situation, the centre may choose to issue a single invoice to the parent, so long as it clearly identifies the two separate payments (the ticket sale and the gift), and may issue a donation receipt for the gift the parent made.

Examples

53. In addition to the following examples, see examples that may be relevant to childcare centre fundraising in QB 16/05: Income Tax – donee organisations and gifts.[19]

Example 1: Discounted attendance fees

A kindergarten requests donations from parents to assist with the upgrade of its playground. Any families who contribute more than $100 are offered a 5% discount off their child's next two months' fees.

Any donations made by parents in excess of $100 are not gifts for donation tax credit purposes. This is because in return for making the payment, the parents gain a material benefit in the form of reduced fees for two months.

Example 2: Contributions and no fees

Growing Giants Preschool is listed as a donee organisation on Inland Revenue's list of approved donee organisations. It offers parents 20 Hours ECE.

Parents are not charged fees for their children to attend the preschool, even if their children attend in excess of 20 hours each week.

However, parents are asked for contributions where a child's attendance exceeds 20 hours per week. The requested contribution is calculated on an hourly rate based on the number of hours the child attends in excess of 20 hours per week, and the children of families who choose not to make the suggested contributions are not able to attend in excess of 20 hours per week.

In addition, all parents are asked for contributions towards the cost of providing children with additional items such as a music teacher and a personally monogrammed sunhat and apron. Families who choose not to make the contributions for these additional items do not get to participate in the music programme and do not get the sunhat or apron.

The contributions parents made are not gifts for donation tax credit purposes. Although a parent may have no legal or contractual obligation to contribute, the family gains a material benefit in return for making the requested contributions. That benefit is that their children obtain the additional goods and services and can attend the preschool, and the parents are relieved from having to pay for that attendance. A sufficient link exists between the payments and the benefit to the families. The amount of the payments relates to the education benefits and goods provided. The preschool should not issue donation tax receipts to the parents for their contributions.

Example 3: Koha paid to kōhanga reo

A kōhanga reo listed on the Inland Revenue website as an approved donee organisation offers its whānau 20 Hours ECE.

The kōhanga reo charges its whānau fees when tamariki attend for more than 20 hours per week. One whānau provides koha in the form of food and other goods instead of paying the fees for their tamariki. This koha is not a gift for tax purposes because the whānau gets the benefit of their tamariki attending at the kōhanga reo in return. The koha is not eligible for donation tax credits.

Another whānau at the kōhanga reo pays the fees for their tamaiti, but they have a surplus of vegetables from their garden. The whānau gives these vegetables to the kōhanga reo, which uses them to provide lunches for the tamariki. This is a gift because it was given voluntarily and there is no material benefit to the whānau. However, the koha is not eligible for donation tax credits because it is not a gift of money.

Some whānau with tamariki may also choose to make cash donations to the kōhanga reo to be spent on improving its teaching facilities. This koha is eligible for donation tax credits providing it is given voluntarily, it benefits the kōhanga reo and there is not a sufficient link between any benefit obtained by the whānau and the koha provided. The kōhanga reo can issue donation tax receipts for qualifying cash donations.

19 *Tax Information Bulletin* Vol 28, No 7 (August 2016): 33.

Example 4: Payments to a community playgroup

St Christopher's Church runs a weekly playgroup in its church hall. The playgroup is open to the community, and any families attending on the day are asked for a gold coin donation. No one is turned away if they do not make a donation.

While a parent's gold coin donation may be a gift, because the donation is less than $5 the parents cannot claim a donation tax credit. No donation tax receipt should be issued.

Periodically, the church newsletter includes a request for donations to help cover the playgroup's operating costs, along with a request for suitable used toys. Any cash donations of $5 or more received by the church in response to the newsletter appeal are gifts for donation tax credit purposes. This is so even if a cash donation is made by a parent who regularly attends the playgroup with their child. While the parent may obtain a benefit from making the payment, there will not be a sufficient link between that benefit and the payment to prevent it from being a gift for donation tax credit purposes. The church can issue a donation tax receipt for the cash donations it receives.

Donations of used toys are not gifts for donation tax credit purposes. No donation tax receipt should be issued.

Example 5: Advertising in exchange for a donation

A childcare centre asks families with businesses for donations. In return, it offers to place an advertisement for the business in its yearbook.

This payment is not a gift for donation tax credit purposes. The business gains a material benefit in the form of advertising in return for making the payment.

Example 6: Tickets to a quiz night

Mi-young purchases a ticket to a quiz night being put on by her children's childcare centre. The centre is a donee organisation and is raising funds for a new interactive garden space. The ticket costs Mi-young $40 and entitles her to attend the quiz night. The childcare centre calculates that about $20 from each ticket sold will go towards its new garden. However, none of the ticket price paid by Mi-young is a gift. The centre has sold the ticket to Mi-young for $40. The centre should not issue a donation receipt to Mi-young for any portion of the ticket price.

The situation would be different if the childcare centre sold each ticket for $20 and at the same time asked parents to consider making a donation of $20, $50, $100 or any other amount. In this case, if Mi-young bought a ticket and opted to make a $20 donation, the centre could issue a donation receipt to her for the $20.

Example 7: Tickets to a fundraising auction

Mateo purchased tickets to attend a fish and chip night and auction to raise funds for a new sunshade at his children's Playcentre. The Playcentre is a donee organisation.

Before the auction night, the Playcentre asks for contributions of "prizes" that it can auction off to raise funds. Kaia, a local artist, donates a painting. The painting would ordinarily sell at one of Kaia's exhibitions for $200. The painting sells at the auction for $350. Although Kaia has donated the painting to the Playcentre, the Playcentre should not give her a donation receipt as she has not made a gift of money.

At the auction Mateo bids on a signed rugby jersey. A similar jersey recently sold in an online auction for $200. Mateo is keen to support the sunshade project so he bids $400 for the signed jersey and wins the auction. Although Mateo may have purchased the jersey for more than the recent online auction price, no amount of the purchase price he paid is a gift. The playcentre should not issue a donation tax receipt to Mateo.

Example 8: Purchase of Christmas cards and a donation

Felicity receives an email from her children's childcare centre, which is operated by a registered charity, offering her the opportunity to purchase a pack of Christmas cards featuring artwork done by the children. On the order form, Felicity can also choose to make a donation to the childcare centre. She chooses to purchase one pack of cards for $20 and to make a donation of $30. She completes the order online, making one payment of $50.

The centre sends her the cards and a donation receipt for $30. This is correct. Felicity's $50 payment comprised two separately identifiable amounts she paid to the centre: $20 to purchase the cards and a $30 voluntary donation. The card order was not conditional on Felicity also making a donation.

References

Legislative references

Charities Act 2005

Education and Training Act 2020, ss 26, 548(5)

Income Tax Act 2007, ss LD 1 to LD 3

Legislation Act 2019, s 10(1)

Tax Administration Act 1994, s 41A(3) and (4)

Case references

Case 8/2018 (2018) 28 NZTC 4,015 (TRA)

Case J76 (1987) 9 NZTC 1,451

Chief Executive of Ministry of Social Development v Broadbent [2019] NZCA 201

Church of Jesus Christ of Latter-Day Saints Trust Board and Coward v CIR [2020] NZCA 143

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Leary v FCT 80 ATC 4,438 (FCA)

R v Coleman (2010) TTC 109 (Canada)

R v Zandstra [1974] 2 FC 254 (Canada)

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OS 22/04: Charities and Donee Organisations - Part 2 Donee Organisations *Tax Information Bulletin* Vol 34, No 10 (November 2022): 44
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QB 23/04: Goods and Services Tax – payments made by parents to childcare centres (Inland Revenue, 2023)

Revenue Alert RA 14/01 *Tax Information Bulletin* Vol 26, No 6 (July 2014): 4
taxtechnical.ird.govt.nz/revenue-alerts/ra-1401-revenue-alert

QB 23/04: Goods and Services Tax – Payments made by parents to childcare centres

Question

When is a parent's payment to their child's childcare centre subject to GST?

Answer

Usually, a parent's payment to their child's childcare centre is subject to GST at the standard rate of 15% where :

- **the childcare centre is GST registered (or should be GST registered); and**
- **the payment is made for the supply of early childhood education, childcare services or related goods.**

However, where a parent makes an unconditional gift to their child's childcare centre and that centre is a non-profit body, then that payment is not subject to GST. This includes some types of koha.

Key terms

Parent includes a child's guardian or caregiver who makes payments to a childcare centre.

Childcare centre includes kindergartens, daycare centres, preschools, early learning centres, crèches, kōhanga reo, Pacific Island language centres, Playcentres, playgroups and the like. It does not include home-based carers or early learning services provided by in-home educators.

Explanation

1. The Commissioner has been asked to clarify the GST treatment of payments parents make to childcare centres. QB 23/03 Income Tax – payments parents make to childcare centres and donation tax credits[1] clarifies when payments parents make to childcare centres will be gifts for donation tax credit purposes.
2. In the past, some parents have made payments incorrectly called "donations" to childcare centres in substitution for paying no or low childcare fees. The Commissioner's view on this practice is addressed in Revenue Alert RA 14/01.[2] Payments parents make to childcare centres incorrectly described as donations are not unconditional gifts for GST purposes.
3. This QWBA assumes childcare centres are registered for GST. Some childcare centres may not need to be registered for GST and so choose not to be GST registered; this QWBA is not relevant to them.

How childcare centres are funded

4. Before considering the GST treatment of a payment a parent makes to a childcare centre, it is helpful to understand the government's role in funding childcare centres, as this helps with understanding the types of payments childcare centres may ask parents to make.
5. The Early Childhood Education (ECE) Funding Subsidy is the primary form of government funding paid to childcare centres that are licensed as ECE service providers under the Education and Training Act 2020. According to Ministry of Education guidelines in *ECE Funding Handbook*,[3] the ECE Funding Subsidy is a contribution to a centre's operating costs, paying for part of each hour each child spends in early childhood education to a maximum of 6 hours per child-place per day (that is, 30 hours per child-place per week). The subsidy is available for any enrolled children aged up to 6 years.
6. Licensed childcare centres that provide ECE services to children aged 3 to 5 years can obtain a higher rate of funding, up to a maximum of 6 hours per child per day and 20 hours per week. This is referred to as "20 Hours ECE". A centre can choose whether to offer parents 20 Hours ECE. Those centres that offer 20 Hours ECE may also claim the ECE Funding Subsidy for any additional hours a child attends over the hours covered by 20 Hours ECE, up to the maximum of 6 hours per day/30 hours per week.

1 Inland Revenue, 2023.

2 *Tax Information Bulletin* Vol 26, No 6 (July 2014): 4

3 Ministry of Education, no date, issued under s 548(5) of the Education and Training Act 2020.

7. According to the *ECE Funding Handbook*, childcare centres cannot charge parents fees for hours claimed as 20 Hours ECE. Parents may be charged fees for attendance hours outside of the hours claimed as 20 Hours ECE per week.
8. Where preschool children need additional hours of care in excess of 20 Hours ECE or are too young to access the 20 Hours ECE (that is, the child is younger than 3 years) some families may qualify for assistance like the Work and Income Childcare Subsidy or Early Learning Payment.
9. Both the ECE Funding Subsidy and the Work and Income payments are paid directly to the childcare centre and not to the parents. Those payments include GST.

Types of payments parents make to childcare centres

10. Despite receiving some government funding, many childcare centres also charge parents fees for attendance and other things. The amount of fees charged, or whether fees are charged, usually depends on the type of childcare centre (for example, whether it is a private "for-profit" childcare centre or a community-based, parent-led not-for-profit organisation).

Fees

11. Subject to the rules relating to 20 Hours ECE (see [6]), a childcare centre can charge fees for a child's attendance at the centre. This includes those childcare centres known as "free kindergartens" (see s 26 of the Education and Training Act 2020).
12. Where a childcare centre charges fees for a child's attendance at the centre, a contractual relationship exists between the centre and the parents for the provision of ECE services in return for the payment of fees.

Optional charges

13. Childcare centres can charge parents for optional activities or goods. These are things a parent purchases from a centre in addition to or to supplement the ECE services the childcare centre provides. The parent can choose whether to purchase the goods or services.
14. The *ECE Funding Handbook* includes information on the optional charges that licensed childcare centres can request, a list of unacceptable charges, and the level of service that must be provided to a parent who chooses not to pay optional charges. Acceptable optional charges include charges for transport, sunscreen, music teachers and sunhats. Unacceptable optional charges include contributions towards the cost of high-quality education, premiums for being a well-regarded service and administration of the 20 Hours ECE. Childcare centres that do not offer 20 Hours ECE are not subject to these rules.

Donations and voluntary contributions

15. Parents may choose or be asked to make donations or voluntary contributions to childcare centres. This is more likely to occur in respect of community-based centres such as free kindergartens, kōhanga reo, Playcentres and playgroups. However, it is possible (although less likely) that private for-profit childcare centres may also occasionally receive donations or voluntary contributions from parents.

Scheme of the Goods and Services Tax Act 1985

16. A GST-registered childcare centre charges GST on the goods and services it supplies in the course or furtherance of its taxable activity at the standard rate of 15% (see s 8 of the Goods and Services Tax Act 1985). A childcare centre's taxable activity is the provision of early childhood education and childcare services to parents along with supplies of related goods and services.
17. The value of a childcare centre's supplies is determined by reference to the "consideration" paid for those supplies (see s 10(2)). "Consideration" is defined in s 2 and includes any payments made in respect of or for the supply of goods and services.
18. Payments for goods and services do not need to be made in only money, but can include forms of payment such as goods or parent help.
19. However, where a childcare centre is a "non-profit body" and a parent's payment is an "unconditional gift" (as defined in s 2), it is not "consideration" for a taxable supply and the payment is not subject to GST.

Unconditional gifts

20. A payment made to a non-profit body is an "unconditional gift" where:
    - the payment is voluntarily made for a non-profit body to carry on or carry out its purposes; and
    - no "identifiable direct valuable benefit" in the form of a supply of goods and services to the payer (or an associated person) arises or may arise in respect of the payment.
21. For more detailed guidance on GST and unconditional gifts, see IS 20/09 GST: Unconditional gifts.[4]

Non-profit bodies

22. Childcare centres can be run in different ways and for different purposes. For example, a childcare centre might be a private for-profit business or it might be operated by a community-based not-for-profit organisation.
23. Only childcare centres that are non-profit bodies (as defined in s 2) can receive unconditional gifts for GST purposes.
24. A childcare centre operated by a non-profit organisation needs to be able to show the centre is:
    - carried on other than for the purposes of profit or gain to any proprietor, member or shareholder; and
    - that its governing documents prohibit the centre from making distributions to any of those people.[5]
25. If a centre is a registered charity, it will be a non-profit body for GST purposes. However, registration under the Charities Act 2005 is not a requirement for being a non-profit body for GST purposes.
26. Childcare centres operated by private for-profit organisations are not non-profit bodies. Donations can still be made to for-profit organisations, but those payments are subject to GST unless it can be established they are not consideration for any supply of goods and services.
27. Practically, for most childcare centres that are non-profit bodies, simply confirming a payment is an unconditional gift will resolve whether the payment is subject to GST. Where it is not clear whether a payment is an unconditional gift, it may be relevant to consider the wider question of whether the payment is, in fact, consideration for a supply of goods or services.

Payment is voluntarily made

28. The first part of the definition of unconditional gift requires the payment to be "voluntarily made". These words are not defined in the Goods and Services Tax Act 1985, so they need to be given an ordinary meaning consistent with the purpose of the definition of unconditional gift (see s 10(1) of the Legislation Act 2019).
29. For the purposes of the definition of unconditional gift, the Commissioner considers a:
    - payment is voluntarily made if it is made freely by choice, is not required to be made or is optional;
    - payment is not voluntarily made if it is made under a legal obligation;
    - legal obligation includes a statutory obligation and in most instances it also includes an obligation under a contract; a payment made under a sense of moral obligation may still be voluntarily made; and
    - non-profit body soliciting donations or recommending the amount of a donation does not, in itself, disqualify a payment from being voluntarily made.

Payments in money or kind

30. For GST purposes, a payment for a supply of goods or services does not need to be made in money (see s 10(2)(b)(i)). Therefore, a payment made by a parent by providing goods or services in return for the supply of childcare services is a payment to that childcare centre, and the centre needs to include that payment for GST purposes. The amount of the parent's payment is established by reference to the open market value of the goods or services the parent provided.

No identifiable direct valuable benefit

31. In the second part of the definition of an unconditional gift, a payment will not be an unconditional gift where an identifiable direct valuable benefit arises or may arise in respect of the payment, in the form of a supply of goods or services to the payer (or an associated person).

4 *Tax Information Bulletin* Vol 33, No 1 (February 2021): 42.

5 See definition of "non-profit body" in s 2 of the GST Act.

32. An "identifiable direct valuable benefit" is an advantage or gain in the form of a supply of goods or services to the payer (or an associated person) that is:
    - clearly able to be defined or identified;
    - sufficiently closely connected to the payment;
    - useful, important and of real value;
    - capable of being valued; and
    - not of only nominal worth.
33. To disqualify a payment from being an unconditional gift, the identifiable direct valuable benefit (in the form of a supply of goods or services) must arise "in respect of" the payment made. That the payer (or an associated person) receives the benefit is not, by itself, enough to take the payment out of the definition of unconditional gift. To be disqualified from being an unconditional gift, a payment must have a sufficient link (or nexus) to the benefit arising in the form of a supply of goods or services. For example, where payment is a requirement of attendance at a childcare centre then that payment is treated as a fee for GST purposes, and not as an unconditional gift (even if the childcare centre does not refer to the payment as a fee).
34. Payments made by parents to meet optional charges for goods and services supplied by a childcare centre (eg, for transport, sunscreen, music teachers and sunhats) are subject to GST. In addition to the payment not being voluntary (as the parents agreed to pay the charge), the family obtain an identifiable direct valuable benefit in the form of a supply of those goods or services in return for making the payment.
35. Where a benefit will arise regardless of whether the payment is made, the connection between the benefit and the payment will not be sufficient, so the payment will be an unconditional gift. The courts have found that for a payment to be an unconditional gift, any benefit arising must not be conditional or dependent on the payment being made.
36. *Case 8/2018* (2018) 28 NZTC 4,015 (TRA) was about whether amounts paid by the parents of children attending a private school were consideration for a supply of education services or unconditional gifts. Judge Sinclair found on the facts that because children were not excluded from attending the school if their parents were unable to pay, their attendance at the school was not "conditional" on parents making the requested financial contributions.
37. However, Judge Sinclair found the school was "dependent" on parents' contributions. This was because it was evident from the background facts before parents made the payments, including the related documentation and correspondence between the school and the parents, that if the parents had not made the contributions, the school would not have been able to operate. For this reason, Judge Sinclair found that in the circumstances a sufficient link could be established between the parents' contributions and the supply of education services the school provided, so the parents' contributions were consideration for the supply of education services, not unconditional gifts.
38. In determining whether a sufficient link exists between the payment and the benefit, the courts will take into account all the circumstances surrounding the payment.
39. A childcare centre may choose to supply goods or services to a parent or other donor as a thank you, acknowledging their generosity. In this case, there will not usually be a sufficient link between the donation and the supply of goods or services for the supply to be "in respect of" the donation (see Example 8: Donation to charity concert in return for free tickets in IS 20/09). In that situation, the payment is not subject to GST.

Examples

Example 1: Payments to daycare centre for additional hours

Starling Daycare Centre is a GST-registered ECE service provider. It offers parents 20 Hours ECE. It is a non-profit centre and has been approved as a donee organisation.

Stella's 3-year-old daughter attends the centre for 30 hours each week. Each week, the centre provides Stella with an invoice for the 10 hours of daycare provided in addition to the 20 hours of the 20 Hours ECE claimed by Stella. The centre charges GST of 15% on the additional 10 hours it supplies. This is the correct treatment for GST purposes.

The additional 10 hours of daycare is a supply of services by the centre to Stella. Payment for these services is consideration for the supply, and not an unconditional gift to the centre.

Example 2: Payment of optional charges to daycare centre

Each month Starling Daycare Centre in Example 1 also invoices Stella for any goods and services she agreed to be charged for. This month's invoice includes optional charges for sunscreen, a sun hat, and lunches. The centre charges GST at 15% on these items. This is the correct treatment for GST purposes.

These are supplies of goods and services Stella has chosen to purchase from the centre rather than supply herself. The goods and services would not have been supplied unless she had agreed to purchase them. Payment for these items is consideration for the supply of the goods and services, and not an unconditional gift to the centre.

Example 3: Requests for contributions but no fees

Growing Giants Preschool is a non-profit organisation. It offers parents 20 Hours ECE.

Parents are not charged fees for their children to attend the preschool, even if their children attend in excess of 20 hours each week.

However, parents are asked for contributions where a child's attendance exceeds 20 hours per week. The requested contribution is calculated on an hourly rate based on the number of hours the child attends in excess of 20 hours per week, and the children of families who choose not to make the suggested contributions are not able to attend in excess of 20 hours per week.

In addition, all parents are asked for contributions towards the cost of providing children with additional items such as a music teacher and a personally monogrammed sunhat and apron. Families who choose not to make the contributions for these additional items do not get to participate in the music programme and do not get the sunhat or apron.

The contributions parents make are not unconditional gifts for GST purposes. Although a parent may have no legal or contractual obligation to make the contribution, an identifiable direct valuable benefit arises in the form of a supply of goods or service in return for the parent making the requested contributions. The benefits are the additional childcare services they receive for the time their children attend the preschool in excess of 20 hours per week and the sunhat and apron.

A sufficient link exists between the payments and the benefits to the families. The preschool should account for GST on the contributions the parents make.

Example 4: Payments to kōhanga reo

A local kōhanga reo offers its whānau 20 Hours ECE. The kōhanga reo is a non-profit organisation.

The kōhanga reo charges its whānau fees when tamariki attend for more than 20 hours per week. One whānau provides koha in the form of food and other goods instead of paying the fees for their tamariki. This koha is not an unconditional gift for GST purposes because it was not given voluntarily and an identifiable direct valuable benefit arises for the whānau in the form of a supply of ECE services in return for the payment to the kōhanga reo. The kōhanga reo should account for GST on this koha.

Another whānau at the kōhanga reo pays the fees for their tamaiti, but they have a surplus of vegetables from their garden. The whānau give these vegetables to the kōhanga reo, which uses them to provide lunches for the tamariki. This is an unconditional gift because it was given voluntarily and no identifiable direct valuable benefit arises in the form of a supply of goods or services to the whānau. This koha is exempt from GST.

Some whānau with tamariki at the kōhanga reo also choose to make cash donations to the kōhanga reo to be spent on improving its teaching facilities. This koha is exempt from GST as an unconditional gift, providing it is given voluntarily and no identifiable direct valuable benefit arises in the form of a supply of goods or services to the whānau making the payment.

Example 5: Payments to a community playgroup

St Christopher's Church runs a weekly playgroup in its church hall. The playgroup is open to the community, and any families attending on the day are asked for a gold coin donation. No one is turned away if they do not make a donation.

The church is GST registered. Attendance at the playgroup is not conditional on the families making the donation. Families can attend the playgroup whether or not they make a gold coin donation. This means the gold coin donation is not made "in respect of" or "for" a family's attendance, so the payment is exempt from GST as an unconditional gift.

Periodically, the church newsletter includes a request for donations to help cover the playgroup's operating costs, along with a request for suitable used toys. Any donations (cash or toys) the church receives in response to the newsletter appeal are unconditional gifts for GST purposes. This is so even if a donation is made by a parent who regularly attends the playgroup with their child. While the parent may obtain a benefit from making the payment, a sufficient link does not exist between that benefit and the payment for it to be considered a "direct" benefit. The donations are exempt from GST as unconditional gifts.

Example 6: Advertising in exchange for a donation

A childcare centre asks families with businesses for donations. In return, it offers to place an advertisement for the business in its yearbook.

This payment is not an unconditional gift for GST purposes. The business gains an identifiable direct valuable benefit in the form of the supply of advertising in return for making the payment.

Example 7: Donation to playcentre for a specific purpose

Jack is a businessperson with two children at his local Playcentre. Jack's company donates $1,000 to the Playcentre for a new sunshade over the sandpit. The company's $1,000 donation is an unconditional gift. The company makes the donation for the Playcentre (a non-profit body) to carry on or carry out its purposes, even though the funds are for a specified purpose.

Jack's company (or Jack and his children) does not receive an identifiable direct valuable benefit as a result of the company's payment. Any benefit Jack's children gain from using the sunshade is not an identifiable direct valuable benefit in the form of a supply of goods or services to an associate of the company. The sunshade is for the benefit of the Playcentre as a whole.

The payment is not subject to GST.

References

Legislative references

Charities Act 2005

Education and Training Act 2020, ss 26, 548(5)

Goods and Services Tax Act 1985, ss 2 ("consideration", "non-profit body", "unconditional gift"), 8, 10(2)

Legislation Act 2019, s 10(1)

Case reference

Case 8/2018 (2018) 28 NZTC 4,015 (TRA)

Other references

ECE Funding Handbook (Ministry of Education, no date)
education.govt.nz/early-childhood/funding-and-data/funding-handbooks/ece-funding-handbook

IS 20/09 GST: Unconditional gifts, *Tax Information Bulletin* Vol 33, No 1 (February 2021): 42
taxtechnical.ird.govt.nz/interpretation-statements/is-20-09

QB 23/03 Income Tax – Payments made by parents to childcare centres and donation tax credits (Question We've Been Asked, Inland Revenue, 2023)

Revenue Alert RA 14/01 *Tax Information Bulletin* Vol 26, No 6 (July 2014): 4
taxtechnical.ird.govt.nz/revenue-alerts/ra-1401-revenue-alert

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 23/02: Assessability of unexplained amounts, interest deductions and shortfall penalties

Technical decision summary - Adjudication

Decision date | Rā o te Whakatau: 21 October 2022

Issue date | Rā Tuku: 29 March 2023

Subjects | Kaupapa

Income tax: unexplained amounts; assessable income; interest deductions.

Shortfall penalties: evasion; obstruction.

Abbreviations | Whakapotonga

The abbreviations used in this document include:

CCS	Customer & Compliance Services, Inland Revenue
Commissioner or CIR	Commissioner of Inland Revenue
ITA	Income Tax Act 2007
NOPA	Notice of Proposed Adjustment
SOP	Statement of Position
PTS	Personal Tax Summary
TAA	Tax Administration Act 1994
TCO	Tax Counsel Office, Inland Revenue

Taxation laws | Ture tāke

This summary refers to the Income Tax Act 2007 (**ITA**) and the Tax Administration Act 1994 (**TAA**).

Facts | Meka

1. The Taxpayer, an individual, had a business. The dispute concerns the tax treatment of several deposits made to bank accounts owned by the Taxpayer and associates of the Taxpayer in the 2010, 2011, 2012 and 2016 income years.
2. The Taxpayer also owned rental properties. The Taxpayer proposed to include an amount of interest on a mortgage as a deduction for the 2016 income year, but the parties disagreed as to the nature of this interest. Customer & Compliance Services, Inland Revenue (**CCS**) argued the interest claimed was in relation to the Taxpayer's family home.
3. The Taxpayer filed tax returns for the 2010 and 2011 income years but there was no mention of rental income or income from the business. The Taxpayer also requested a personal tax summary (**PTS**) for the 2012 income year. The Taxpayer filed a tax return for the 2016 income year. The return recorded a rental income loss.
4. The Taxpayer did not return any business income until 2016. The Taxpayer stated that income relating to the 2015 and 2016 income years for the business was fully returned by a company (**the Company**). The sole director and shareholder of the Company was the Taxpayer's spouse.

Issues | Take

5. The main issues considered in this dispute were:
   - whether the deposits were assessable income to the Taxpayer;
   - whether the Taxpayer was entitled to interest deductions under ss DA 1 and DA 6 of the ITA;
   - whether the Taxpayer was liable for an evasion shortfall penalty;
   - whether the Taxpayer was liable for an increase in the shortfall penalty for obstruction.
6. A preliminary issue of whether the Commissioner was entitled to amend the Taxpayer's assessments to increase the amounts outside the four-year period in s 108 of the TAA was also considered.

Decisions | Whakatau

7. The Tax Counsel Office (**TCO**) concluded that:
   - the deposits made in the 2016 income year were assessable income to the Taxpayer, but not the deposits made in the 2010 income year;
   - the Taxpayer was not entitled to the interest deductions;
   - evasion penalties should be applied as proposed for the 2012 and 2016 income years, but not for the 2011 income year (the gross carelessness penalty should be imposed for the 2011 income year);
   - all penalties should be increased by 25% for obstruction.

Reasons for decisions | Pūnga o ngā whakatau

Preliminary issue | Take tōmua: Time bar

8. All legislative references in this issue are to the TAA unless otherwise stated.
9. Subject to some exceptions, s 108(1) prevents the Commissioner from amending an income tax assessment so as to increase the amount assessed or decrease 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.
10. However, if an exception applies, the Commissioner may amend an otherwise time-barred assessment.
11. For this dispute, all disputed periods would be time barred under s 108(1) unless an exception applies.
12. The relevant exceptions are in s 108(2), which provides that the Commissioner may amend an assessment at any time so as to increase its amount if the Commissioner is of the opinion that a tax return provided by a taxpayer:
    - is fraudulent or wilfully misleading; or
    - does not mention income of a particular nature or derived from a particular source.

13. It is sufficient that the Commissioner honestly believes, on the available evidence and on the correct application of the law, that the tax return meets the requirements for the time bar exception to apply.[1] A challenge to the Commissioner's opinion can only succeed if the taxpayer shows that:[2]
    - the Commissioner did not honestly hold the opinion, or
    - the Commissioner misdirected himself 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 him.
14. The decision to rely on s 108(2) is a disputable decision.[3] This means that any challenge to this decision may have regard not only to the validity of the Commissioner's opinion but also to the correctness of the opinion itself.[4]
15. Even if the Commissioner has validly formed his opinion, this will not prevent a court or a hearing authority from considering the requirements of s 108(2) anew. The burden of proof, however, rests with the taxpayer to show, on the balance of probabilities, that the decision made by the Commissioner is wrong and that the statutory requirements are not met.[5]
16. TCO considered it appropriate to adopt a similar approach to that which a hearing authority would follow in respect to the onus of proof. Therefore, TCO considered the issue of the time bar anew, using the evidence available to TCO.

Fraudulent or wilfully misleading

17. For the exception in s 108(2)(a) to apply, the Commissioner must be of the opinion that the tax return is fraudulent or wilfully misleading.
18. For a return to be fraudulent, the person filing it must have known that it was incorrect and nevertheless dishonestly or deceitfully filed it that way.[6] In the case of a company, fraudulence is imputed via a responsible officer or officers of the company.[7]
19. TCO considered the meaning of "wilfully misleading" and concluded the following:
    - Whether or not a return is misleading is a question of fact.[8]
    - Whether or not a return is wilfully misleading concerns the "state of mind" of the person filing the return.[9] There must be evidence that the act complained of was deliberate and intentional, not accidental or inadvertent.[10]
    - An omission, as well as an act, may be wilful.[11]
    - Subjective recklessness is sufficient as proof of wilfulness if the person had no reasonable grounds for believing the returns were correct and was reckless in the sense of not caring whether they were correct.[12]
20. Therefore, a return will be "fraudulent or wilfully misleading" when the taxpayer:
    - filed it knowing that it did not reflect their true income tax position, or
    - was recklessly careless as to whether or not the return was wrong.
21. The burden of proof rests with the taxpayer to show that a return is not fraudulent or wilfully misleading. The standard of proof is the civil standard, ie on the balance of probabilities.[13]

1 See *Wire Supplies Ltd v CIR* [2007] NZCA 244, (2007) 23 NZTC 21,404 at [87].

2 *Auckland Institute of Studies v CIR* (2002) 20 NZTC 17,685 (HC) at [102].

3 Definition of "disputable decision" in s 3(1).

4 *Edwards v CIR* [2016] NZHC 1795, (2016) 27 NZTC 22-064; *Great North Motor Company Limited (in receivership) v CIR* [2017] NZCA 328, (2017) 28 NZTC 23-022. See also *Van Uden v CIR* [2018] NZCA 487, (2018) 28 NZTC 23-081 at [69].

5 *Great North Motor* (CA) at [32] and [34]; *Auckland Institute of Studies* at [102].

6 Definition of "fraudulent" in *Concise Oxford English Dictionary* (12th ed, Oxford University Press, Oxford, 2011). The meaning of "fraudulent" was considered in *R v Coombridge [1976] 2 NZLR 382 (CA) at 387.*

7 *Meulen's Hair Stylists v CIR* [1963] NZLR 797 (SC) at 799.

8 *Great North Motor* (CA) at [37].

9 *R v Senior* [1899] 1 QB 283; *Great North Motor* (CA) at [40].

10 *Case W26* (2003) 21 NZTC 11,263 at [110]. See also *CIR v Parisienne Gown Company Limited; CIR v Gold* [1956] NZLR 442 (NZSC) at 444.

11 *In Re City Equitable Fire Insurance Co Ltd* [1925] 1 Ch 407 at 434. See also *Babington v CIR* (No. 2) [1958] NZLR 152 (NZSC) at 156–157.

12 *Great North Motor* (CA) at [36].

13 *Great North Motor* (CA) at [34].

22. TCO considered that the knowledge requirement for s 108(2)(a) is consistent with the consideration of the evasion shortfall penalty under s 141 (discussed in Issue 3 below), which requires determining whether the Taxpayer knowingly evaded the assessment of tax. The knowledge element of evasion can be satisfied through actual knowledge that an action or omission would breach a tax obligation or through subjective recklessness.
23. In Issue 3, in the context of the evasion shortfall penalty under s 141E, TCO concluded that the Taxpayer evaded assessment or payment of tax when they took the tax positions for the 2012 and 2016 income years for these reasons:
    - Based on the evidence presented in this dispute, TCO concluded that the Taxpayer knew they were breaching their tax obligations by not returning rental income and business income. This knowledge can also be inferred from the Taxpayer's business experience. The Taxpayer failed to disclose the information to Inland Revenue, going so far as to proactively provide misleading information about their requirement to file in their phone calls with Inland Revenue.
    - Even if the Taxpayer did not know they were in breach of their tax obligations, TCO considered the evidence indicated that facts actually known to the Taxpayer were such that they must have put them on inquiry that a tax obligation may not be met but they made the conscious decision to proceed by filing returns excluding rental and business income.
24. CCS formed the opinion that the Taxpayer's returns (including their PTS for the 2012 income year) were fraudulent or wilfully misleading. There was nothing to indicate that:
    - this opinion was not honestly held, or
    - the Commissioner misdirected himself 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 him.
25. For the above reasons, it was concluded that the exception to the time bar under s 108(2)(a) applied to allow the Commissioner to assess the 2012 and 2016 income years. However, the exception in s 108(2)(a) did not apply to allow the Commissioner to assess the 2011 income year.
26. The Commissioner could assess the 2011 income year if the exception in s 108(2)(b) applies. This is discussed next.

Does not mention income

27. For the exception in s 108(2)(b) to apply, the Commissioner must be of the opinion that the tax return does not mention:
    - income which is of a particular nature, or
    - income derived from a particular source,

    and in respect of which a tax return is required to be provided.
28. In respect of this exception, TCO came to the following conclusions:
    - Income of a particular nature is income that has a basic or inherent feature, quality or character. The source of the income is where it is from.[14]
    - Income must be mentioned in or with the return of the taxpayer seeking the protection of the time bar. The disclosure of income at some other time, or in another taxpayer's return, will not suffice.[15]
    - The omission of income does not need to be fraudulent or deliberate.[16]
    - Once it is determined that the time bar exception applies, the Commissioner is not confined to the omitted sums but may amend the whole assessment.[17]
    - Section 108(2)(b) is not directed at the failure to characterise a gain as income. Rather, it is directed at the failure to mention the gain at all.[18]
29. The Taxpayer acknowledged that they derived rental income in all the disputed periods, and business income in the 2011 and 2012 income years. The Taxpayer did not return any of this income in their returns (including the PTS for the 2012 income year) for the disputed periods.

14 The definitions of "nature" and "source" in the *Concise Oxford English Dictionary*. See *Case T52* (1998) 18 NZTC 8,378 at 8,400–8,401.
15 *Miller v CIR (1998)* 18 NZTC 13,961 (HC) at 13,975.
16 *Babington v CIR* [1957] NZLR 861 (NZSC).
17 *Babington* at 869.
18 *Cross v CIR (1987)* 9 NZTC 6,101 (CA); *Case Z19* (2009) 24 NZTC 14,217.

30. Rental income and business income are distinct categories of income that are required to be returned, and they are also types of income derived from particular sources (tenants and business clients respectively). The Taxpayer, by failing to return any of this income, failed to return income of a particular nature or derived from a particular source.
31. Therefore, s 108(2)(b) applied to allow the Commissioner to assess the Taxpayer for the periods in dispute, including the 2011 income year.

Issue 1 | Take tuatahi: Whether deposits were assessable income

32. All legislative references in this issue are to the ITA unless otherwise stated.
33. This issue concerns whether deposits made to bank accounts owned by or accessible by the Taxpayer in the 2010 and 2016 income years were taxable income of the Taxpayer, either as business income under s CB 1 or income under ordinary concepts under CA 1(2).
34. CCS considered cash deposits and substantial business expenses showed the Taxpayer derived income from their business in the 2010 income year. CCS also considered deposits paid into the bank accounts of the Taxpayer's relatives were income of the Taxpayer.
35. The Taxpayer asserted that they did not derive income in relation to the business until the 2011 income year. The Taxpayer also considered that all income derived in the 2016 income year had been returned by the Company.

Onus and standard of proof

36. The onus of proof in civil proceedings[19] is on the taxpayer, except for shortfall penalties for evasion or similar act, or obstruction.[20] The taxpayer must prove that an assessment is wrong, why it is wrong, and by how much it is wrong.[21]
37. The standard of proof in civil proceedings is the balance of probabilities.[22] This standard is met if it is proved that a matter is "more likely than not".[23]
38. An assessment made by the Commissioner cannot be arbitrary. He must make the best judgment he can on the information in his possession as to the amount of taxable income and the amount of tax payable. In some cases, a taxpayer may be able to discharge the onus of proof by showing that the assessment is arbitrary or demonstrably unfair.[24]

Assessability of unexplained amounts

39. The law concerning the assessability of unexplained amounts received by a taxpayer is well settled. It is for the taxpayer to prove that the Commissioner's proposed adjustments are wrong and by how much they are wrong.[25] The standard of proof is the balance of probabilities.[26]
40. The taxpayer can meet the onus of proof if the taxpayer provides specific details of other sources of funds that are capital or non-taxable in nature.[27] This requires the taxpayer to do more than simply provide a credible possible alternative explanation for the amounts.[28] The taxpayer must establish that the Commissioner's assessment is incorrect and by how much it is incorrect.[29]

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

20 Section 149A(2) of the TAA.

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

22 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.

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

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

25 *Buckley & Young Ltd* at 61,283.

26 *Yew v CIR* (1984) 6 NZTC 61,710 (CA); *Case Y3* (2007) 23 NZTC 13,028; *Case X16* (2005) 22 NZTC 12,216.

27 *Case L40* (1989) 11 NZTC 1,249.

28 *Case E69* 5 NZTC 59,378 at p 59,380.

29 *Case S30* (1995) 17 NZTC 7,207; *Case 2/2017* [2017] NZTRA 02, (2017) 28 NZTC 4-001.

41. It will depend on the facts of the particular case as to what evidence will be required to discharge a taxpayer's onus of proof. The courts will normally test statements made by taxpayers against the surrounding circumstances.[30] This generally means that the taxpayer must provide evidence in support of their claims, including corroborative evidence, in particular contemporaneous evidence and records.[31] If the taxpayer has provided no such evidence, and there is no compelling reason for disallowing the Commissioner's assessment, a court is likely to uphold the assessment.[32]

Taxation of unexplained amounts

42. It is in the nature of unexplained income that the exact tax character of the income may be unknown. Generally, the unexplained amounts are treated as income under s CA 1(2) (income under ordinary concepts).

Income under ordinary concepts

43. Section CA 1(2) provides that an amount is income of a person if it is their income under ordinary concepts.
44. Some key principles derived from case law on income under ordinary concepts are:
    - Income is something that "comes in".[33]
    - Whether or not a particular receipt is income depends on its quality in the hands of the recipient.[34]
    - The periodic nature of payments made is the major determinant in many cases. Regularity or recurrence indicates that payments may become part of the receipts on which the recipient may depend for their living expenses.[35]
    - Consideration must be given to the relationship between the payer and the payee.[36]
    - The purpose of any payments made must be taken into account.[37]

Business income

45. CCS also argued that the deposits were business income of the Taxpayer.
46. *Grieve v CIR*[38] is the leading case that considers the definition of business.[39] The key principles from *Grieve are:*
    - Determining whether a business exists involves a twofold inquiry comprised of analysing the nature of the activities carried on and the intention of the taxpayer in engaging in those activities.
    - Underlying the term "business" in the context of tax law is the fundamental notion of the exercise of an activity in an organised and coherent way, and one which is directed to an end result.[40] Factors for determining the nature of a taxpayer's activities include:
        - The period over which it is engaged in.
        - The scale of operations and volume of transactions.
        - The commitment of time, money and effort.
        - The pattern of activity.
        - The financial results.

Deposits in the 2010 income year

47. CCS considered the Taxpayer derived business income in the 2010 income year as shown by deposits included in the Taxpayer's credit card statements. However, this proposed adjustment was made in a letter after a Statement of Position (**SOP**) was issued and were not included in the Commissioner's Notice of Proposed Adjustment (**NOPA**).

30 *National Distributors Ltd v CIR* (1989) 11 NZTC 6,346 (CA) at 6,351. See also *Buckley & Young* at 61,283 and *Case E69* at 59,380.

31 *Case 8/2017* [2017] NZTRA 08, (2017) 28 NZTC 4-007 at [46].

32 *Alexander v CIR* (1996) 17 NZTC 12,543 (HC) at 12,544. This decision was appealed to the Court of Appeal in *Alexander v CIR* (1998) 18 NZTC 13,921 (CA) where it was confirmed that the taxpayer had not discharged the onus of proof.

33 *Tennant v Smith* (1892) 3 TC 158; *A Taxpayer v CIR* (1997) 18 NZTC 13,350 (CA) at 13,355.

34 *Reid v CIR* (1985) 7 NZTC 5,176 (CA) at 5,183.

35 *Reid v CIR*; *A Taxpayer*; *FCT v Hyteco Hiring Pty Ltd* 92 ATC 4694 at 4,700.

36 *Reid v CIR*.

37 See for example in *Reid* where the payments were contractual and received in return for performing student obligations.

38 *Grieve v CIR* [1984] 1 NZLR 101 (CA)

39 The definition of "business" in s YA 1 includes any profession, trade, or undertaking carried on for profit.

40 At 61,689.

48. TCO considered that these deposits were outside the scope of the dispute and it would be inconsistent with the requirements of s 89C of the TAA for the Commissioner to make an assessment relating to the credit card deposits without first issuing a NOPA.
49. Therefore, TCO concluded that the adjustment proposed by CCS in its post-SOP letter should not be made at this time. If the Commissioner wishes to propose adjustments relating to deposits in the 2010 income year, he will need to issue a new NOPA.

Deposits in the 2016 income year

50. CCS asserted that several deposits made into the accounts of the Taxpayer's relatives were not returned by the Company in the 2016 income year. The Taxpayer asserted that all income and expenses relating to the business were accounted for by the Company for the 2016 income year. The Taxpayer also asserted that CCS's inclusion of deposits into the relatives' accounts was arbitrary.
51. The onus of proof is on the Taxpayer to show the adjustments proposed by the Commissioner were wrong and by how much they were wrong. Further, to prove on the balance of probabilities that unexplained amounts were not income, the Taxpayer was required to do more than simply provide a credible possible alternative explanation for the amounts. The Taxpayer must establish that the Commissioner's assessment was incorrect.
52. The information available to CCS, including bank statements and vouching information of the relatives' bank accounts, indicated that the Taxpayer was making deposits into these accounts for the purpose of concealing income from the business. The information also showed that the Taxpayer had access to these accounts during the 2016 income year and that several payments were transferred to the Taxpayer's personal account.
53. The Taxpayer argued that the transfers to the Taxpayer's account related to expenses incurred by the relative's family. While this might be a credible explanation for some of the transfers or deposits, the Taxpayer did not provide sufficient evidence to prove on the balance of probabilities that the deposits were not income of the Taxpayer, despite multiple requests from CCS to the Taxpayer for further explanations of the deposits. Nor did the Taxpayer provide any evidence to indicate that CCS's proposed adjustments were arbitrary or demonstrably unfair.
54. The Taxpayer acknowledged that they were carrying on a business in the 2016 income year, although maintained the income was returned by the Company. It was therefore not necessary for TCO to determine whether the Taxpayer was carrying on a business during the relevant period.
55. As the Taxpayer did not satisfy the burden of proof to show that the amounts were not income, it was considered that the Commissioner was empowered to tax these deposits as business income under s CB 1 or as income under ordinary concepts, based on the information available to the Commissioner.

Issue 2 | Take tuarua: whether the Taxpayer was entitled to interest deductions

56. All legislative references in this issue are to the ITA unless otherwise stated.
57. This issue concerns whether a deduction proposed by the Taxpayer for the 2016 income year in relation to interest on a mortgage is deductible under s DB 6.[41]
58. The Taxpayer asserted that the interest related to a rental property. However, the Commissioner considered that the relevant loan facility was used to pay the balance of the loan for the family home. Accordingly, CCS considered the expenditure was of a private or domestic nature and was therefore not deductible in accordance with the private limitation.
59. Section DB 6(1) provides that a person is allowed a deduction for interest incurred. Section DB 6(1) overrides the capital limitation, but the general permission must still be satisfied, and the other general limitations still apply (s DB 6(2)). Section DB 6(1) is subject to the limitations in s DB 1, however that provision is not relevant for the purposes of this dispute.

41 This issue was not affected by changes to deductibility of interest for residential rental properties as the relevant provisions did not yet apply during the disputed periods.

60. The test for interest deductibility, commonly referred to as the "use test", is whether the borrowed funds on which the interest is incurred have been used in deriving income, or in a business carried on to derive income. The test is whether the capital lent was used or employed in the process of deriving assessable income during the period in which the interest was incurred. It is not relevant how the capital was previously or subsequently employed.[42]
61. As stated above, s DB 6 is still subject to the general limitations (other than the capital limitation). The private limitation denies a deduction for expenditure or loss to the extent it is of a private or domestic nature.
62. An outgoing is of a private nature if it is exclusively referable to living as an individual member of society and domestic expenses are those relating to the household or family unit.[43] Private or domestic expenditure is often expenditure that is not of a business nature.[44]
63. In this dispute, the information available to CCS showed that the relevant loan facility related solely to the Taxpayer's family home. The Taxpayer did not provide any evidence to show that the loan facility was used for a rental property activity and not the family home as argued by CCS. Therefore, the Taxpayer has failed to satisfy the onus of proving that CCS's proposal to deny the deduction for the interest expenditure was wrong and by how much.
64. TCO concluded that the Taxpayer was not allowed a deduction for the interest expenditure relating to the relevant loan facility.

Issue 3 | Take tuatoru: whether the Taxpayer was liable for an evasion shortfall penalty

65. All statutory references in this issue are to the TAA unless otherwise stated.
66. The issue is whether the Taxpayer is liable under s 141E for a shortfall penalty for evasion or a similar act.
67. If the Taxpayer is liable for an evasion shortfall penalty, CCS accepts that the shortfall penalty will be reduced by 50% under s 141FB for previous behaviour.
68. Section 141E(1)(a) imposes a shortfall penalty for evasion on a taxpayer if the following requirements are satisfied:[45]
    - The taxpayer has taken a tax position. A tax position is a position or approach to tax under a tax law as taken in or in respect of a tax return, income statement, or due date.
    - Taking the tax position has resulted in a tax shortfall. A tax shortfall is the difference between the tax effects of the correct tax position and the tax effects of the taxpayer's tax position.
    - The taxpayer has evaded the assessment or payment of tax. Evasion requires an intention to avoid the assessment or payment of tax known to be chargeable:
        - The element of intention will be satisfied if the taxpayer knows that their action or omission will breach a tax obligation. There must be some blameworthy act or omission on the part of the taxpayer. The required intent for evasion can be inferred from surrounding circumstances and conduct.[46]
        - Recklessness can amount to evasion and involves the conscious taking of risk. Recklessness will be proven where:[47]
            - Facts actually known to the taxpayer were such that they must have put the taxpayer on inquiry that a tax obligation may not be met.
            - The taxpayer made a conscious decision to ignore the facts without making further inquiry.
69. The penalty payable for evasion or similar act is 150% of the resulting tax shortfall.

42 *Pacific Rendezvous Ltd v CIR* (1986) 8 NZTC 5,146 (CA); applied in *Eggers v CIR* (1988) 10 NZTC 5,153 (CA) and *CIR v Brierley* (1990) 12 NZTC 7,184 (CA). It is noted that these cases considered the application of s 106(1)(h) of the Income Tax Act 1976. Despite the change in the words of the legislation, subsequent decisions in the TRA have continued to rely on the "use test". Therefore, it is considered that the "use test" as formulated by the Court of Appeal in *Pacific Rendezvous* continues to be good law.

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

44 *Reid v CIR* (1990) 12 NZTC 7,153 (HC).

45 The shortfall penalty for evasion or a similar act is considered in the Interpretation Statement: Shortfall Penalty—Evasion as published in *Tax Information Bulletin* Vol 18, No 11 (December 2006).

46 *Taylor v Attorney-General* [1963] NZLR 261 (SC); *Lloyds Bank Ltd v Marcan* [1973] 2 All ER 359; *Case H90* (1986) 8 NZTC 619; *Case N47* (1991) 13 NZTC 3,388; *R v G* [2013] NZCA 146.

47 *Case H90* (1986) 8 NZTC 619; *R v Harney* [1987] 2 NZLR 576 (CA); *Case P29* (1992) 14 NZTC 4,213; *Case S100* (1996) 17 NZTC 7,626; *R v G* [2013] NZCA 146.

70. The penalty may be:
    - apportioned between the taxpayer and an officer of the taxpayer under s 141F.
    - reduced for previous behaviour under s 141FB.
    - reduced for voluntary disclosure under s 141G.
    - reduced for temporary shortfall under ss 141I and 141J.
    - increased for obstruction under s 141K.
71. The onus of proof rests with the Commissioner to show that a taxpayer is liable for a shortfall penalty for evasion under s 141E.[48] This is different from the other shortfall penalties where the onus of proof is on the taxpayer. The standard of proof is the balance of probabilities.[49]
72. In this dispute, the Taxpayer took a "tax position" by filing returns for the 2010, 2011, and 2016 income years, and through their PTS for the 2012 income year. A tax shortfall arose for the 2011 and 2012 income years as accepted by the Taxpayer, and for the 2016 income year as TCO concluded above. However, no tax shortfall arose in the 2010 income year as TCO concluded that the adjustments proposed by CCS should not be made at this time.
73. The next question is whether the Taxpayer had the necessary intent for the evasion penalty to apply.
74. As the burden of proof for an evasion shortfall penalty is on the Commissioner, CCS must demonstrate on the balance of probabilities that, in taking these tax positions, the Taxpayer evaded the assessment of tax. The element of intention required for evasion will be satisfied if the taxpayer knows that an action or omission will breach a tax obligation. Subjective recklessness can also amount to evasion.
75. CCS argued that the intention element of evasion was satisfied as the Taxpayer's behaviour was deliberate, or alternatively the Taxpayer was subjectively reckless as to whether their actions or omissions would breach a tax obligation.
76. As mentioned in paragraph 23 above, TCO concluded that the Taxpayer evaded assessment or payment of tax when they took the tax positions for the 2012 and 2016 income years for the reasons summarised in that paragraph.
77. However, the evidence supported a finding of evasion for the tax positions taken for the 2012 and 2016 income years only. Some of the evidence presented in the dispute was not supportive of evasion for the 2011 income year. This included evidence of phone calls with Inland Revenue, which occurred after the Taxpayer took the tax position for the 2011 income year.
78. It was concluded that CCS satisfied the burden of proving that the Taxpayer evaded the assessment or payment of tax when they took the tax positions for the 2012 and 2016 income years. However, CCS did not satisfy the burden of proving evasion in relation to the 2011 income year. The gross carelessness shortfall penalty will apply for the 2011 income year instead, as accepted by the Taxpayer.
79. Therefore, the Taxpayer is liable for shortfall penalties for gross carelessness under s 141C for the 2011 income year and evasion under s 141E for the 2012 and 2016 income years, reduced by 50% for previous behaviour.

Issue 4 | Take tuawhā: whether shortfall penalty should be increased for obstruction

80. All legislative references in this issue are to the TAA unless otherwise stated.
81. This issue concerns whether it is appropriate to increase the shortfall penalties the Taxpayer is liable to pay by 25% for obstruction in accordance with s 141K.
82. CCS considered that the Taxpayer was liable for an increase for obstruction on the basis that they had been uncooperative and impeded CCS's ability to carry out its lawful duties
83. Section 141K provides a shortfall penalty under any of sections 141AA to 141EB may be increased by 25% if the taxpayer obstructs the Commissioner in determining the correct tax position in respect of the taxpayer's tax liability.

48 Section 149A(2) of the TAA.

49 Section 149A(1) of the TAA.

84. Obstruction occurs when a taxpayer takes actions that make it more difficult for the Commissioner or an officer of the Commissioner to carry out their lawful duties. Words alone can constitute obstruction, including actions like lying at an interview or deliberately delaying Inland Revenue enquiries. Actions such as exercising legal rights, contesting an assessment, or maintaining an opinion contrary to the Commissioner are not obstruction. For conduct to be obstruction it must also be made without justification or lawful excuse.[50]

85. As with evasion, the onus of proof rests with the Commissioner to show that a taxpayer is liable for an increase in a shortfall penalty for obstruction (s 149A(2)(a)). The standard of proof is the balance of probabilities (s 149A(1)).

86. TCO acknowledged that this issue was finely balanced as there may have been justifications or explanations for some of the Taxpayer's actions. Nevertheless, on balance, TCO considered that the Taxpayer's continual and undue delays, misleading statements, diversion of income into other relatives' bank accounts and repeated failure to be forthcoming with information about deposits and bank accounts, delayed and made it more difficult for the Commissioner to carry out his audit of the Taxpayer's affairs. These factors affected the 2011, 2012 and 2016 income years, in respect of which it has been concluded shortfall penalties apply.

87. Accordingly, it was concluded that CCS has satisfied the onus of proving on the balance of probabilities that the Taxpayer obstructed the Commissioner in determining the correct tax position in respect of the Taxpayer's tax liabilities. Further, it was considered that these actions were done without justification or lawful excuse.

88. Therefore, the Commissioner may increase the shortfall penalties that the Taxpayer is liable to pay for the 2011, 2012 and 2016 income years by 25%.

50 See *Tax Information Bulletin* Vol 8, No 7 (October 1996) at 24.

TDS 23/03: Income tax: Timing of income and expenditure

Technical decision summary - Adjudication

Decision date | Rā o te Whakatau: 25 August 2022

Issue date | Rā Tuku: 3 April 2023

Subjects | Kaupapa

Income tax: When did the Taxpayer derive the maintenance component of the lease income? When was the Taxpayer entitled to deduct the maintenance expenditure?

Abbreviations | Whakapotonga

The abbreviations used in this document include:

CCS	Customer & Compliance Services, Inland Revenue
ITA 2007	Income Tax Act 2007

Taxation laws | Ture tāke

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

Facts | Meka

Introduction

1. The Taxpayer carried on a business which involved leasing assets to customers under lease contracts (the **leases**). The Taxpayer was obliged to maintain the leased assets in good repair and operating condition during the terms of the leases.
2. When the Taxpayer determined the amount it would charge under the leases, it calculated two main components:
   - the lease of the assets (lease component), and
   - the maintenance costs the Taxpayer expected to incur during the term of the agreement (maintenance component).
3. The terms of the leases did not break the contract price down into those components. Instead, each lease contract provided for the payment of a single sum which was described in the leases as **rental.**

Accounting treatment of income from the leases

4. For accounting purposes, the Taxpayer applied NZ IFRS 15 when reporting the income it earned under the leases. Prior to adopting NZ IFRS 15, the Taxpayer recognised all of the rental under the leases in the accounting period to which the rental related.
5. In the application of NZ IFRS 15 to the leases, the Taxpayer considered the maintenance component was a distinct revenue stream and the performance obligations it carried out in relation to this revenue were the maintenance responsibilities it had under the leases. Therefore, during the terms of the leases, the Taxpayer recognised the maintenance component of the rental under the leases to the extent that it had incurred expenditure meeting its maintenance obligations.
6. As to the lease component, the Taxpayer recognised this in the accounting period to which it related.

Tax treatment of income from the leases

7. In its tax returns for the years in dispute the Taxpayer recognised the rental in the period to which it related (as it had prior to adopting NZ IFRS 15 for accounting purposes). The Taxpayer subsequently disputed its self-assessments and proposed to adjust the tax treatment to align with the accounting treatment under NZ IFRS 15.

Matters in dispute

8. The Taxpayer argued the rental under the leases was not derived until it "came home" and this occurred when the Taxpayer's income earning process was complete.[1]
9. As applied to the maintenance component, the Taxpayer argued its income earning process involved the provision of maintenance services. The Taxpayer considered this process was only completed to the extent that the Taxpayer had performed its maintenance responsibilities under the leases. Further, the Taxpayer considered the appropriate measure for determining the extent to which the Taxpayer's maintenance responsibilities had been performed was the amount of expenditure that the Taxpayer incurred carrying those responsibilities out.
10. The Taxpayer argued in the alternative that, if it was wrong and the maintenance component of the rental under the leases was derived on a current year basis, it was entitled to deduct maintenance expenditure up to the value of the maintenance component derived in each income year.[2]
11. CCS argued that the correct view of the contractual arrangements the Taxpayer entered into under the leases was that no part of the rental was payment for maintenance services. That is:
    - The rental was entirely a payment for the provision of fully maintained assets for a set term.
    - There was no basis for deferring recognition of the maintenance component in the manner argued by the Taxpayer.
12. CCS also rejected the Taxpayer's alternative argument on the ground that it would involve the Taxpayer obtaining deductions for maintenance expenditure it had not incurred.

Issues | Take

13. The primary issue is when does the Taxpayer derive the maintenance component of the rental. To establish this the Tax Counsel Office addressed the following sub-issues:
    - What was the nature of the process by which the Taxpayer earned its income and when was the process complete?
    - What was the correct characterisation of the arrangements that the Taxpayer entered into under the leases?
    - What was the relevance of the accounting treatment that the Taxpayer adopted under NZ IFRS 15 when it prepared its accounts?
14. The alternative issue was when does the Taxpayer incur the maintenance expenditure?
15. In addition, the onus and standard of proof were dealt with as a preliminary issue.

Decisions | Whakatau

16. The Tax Counsel Office decided the adjustments proposed by the Taxpayer should not be made because:
    - The Taxpayer derived the rental under the leases when and to the extent that it had met its contractual obligation to supply assets in good repair and operating condition and was entitled to issue an invoice for the supply.
    - The Taxpayer did not incur the maintenance expenditure at the time the leases were entered into. The Taxpayer incurred expenditure when the services the expenditure was payment for were provided.

Reasons for decisions | Pūnga o ngā whakatau

Preliminary issue | Take tōmua: The onus and standard of proof

17. The onus of proof in civil proceedings[3] is on the taxpayer, except for shortfall penalties for evasion or similar act, or obstruction.[4] The taxpayer must prove that an assessment is wrong, why it is wrong, and by how much it is wrong.[5]

1 *Arthur Murray (NSW) Pty Ltd v FCT* (1965) 114 CLR 314; *CIR v Mitsubishi Motors New Zealand Limited* (1994) 16 NZTC 11,099 (CA).

2 *CIR v Mitsubishi Motors New Zealand Limited* (1995) 17 NZTC 12,351 (PC).

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

4 Section 149A(2) of the TAA.

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

18. The standard of proof in civil proceedings is the balance of probabilities.[6] This standard is met if it is proved that a matter is more probable than not.

19. The onus of proof rests with the Commissioner to show that a taxpayer is liable for a shortfall penalty for evasion under s 141E of the TAA.[7] This is different from the other shortfall penalties where the onus of proof is on the taxpayer. The standard of proof is the balance of probabilities.[8]

Issue 1 | Take tuatahi: When does the Taxpayer derive the maintenance component of the rental?

The parties' rights and obligations

20. Under the terms of the leases the Taxpayer was responsible for all repairs, labour costs and materials necessary to keep the assets in good repair and operating condition. The effect of this was that scheduled and unscheduled maintenance was the Taxpayer's responsibility and at the Taxpayer's cost. Consequently, the Tax Counsel Office considered that the carrying out of scheduled and unscheduled maintenance did not involve the provision of maintenance services to the Taxpayer's customers. It followed that the rental under the leases was entirely payment for the provision of the assets which the Taxpayer was under an obligation to keep in a state of good repair and operating condition, and not to any extent payment for maintenance services provided by the Taxpayer.

Income earning process

21. The tax consequences of a transaction turned on the legal arrangements entered into and carried out by the parties to the transaction, and not by reference to some other economically equivalent arrangement the parties may have entered into but chose not to.[9] In addition, the true nature of a transaction is determined by the contract that embodies the transaction.[10] For this purpose the approach to be taken when interpreting a contract is an objective one.[11]

22. Therefore, the Tax Counsel Office considered it was not permissible to treat the rental under the leases as though it were, in part, prepayment for services when it was in legal substance a payment for the provision of an asset in good repair and operating condition. Under the accruals method of income recognition income was earned when a person's income earning process was complete. It followed that the Taxpayer's income earning process was complete when and to the extent that it had met its contractual obligation to supply an asset in good repair and operating condition and it was entitled to issue an invoice for the supply.

Contingency of repayment

23. In *Arthur Murray* the Court found that prepayments for dancing lessons were not derived when received because there was a possibility they might have to be paid back by way of damages should the dancing lessons not be provided.[12] The Taxpayer argued that *Arthur Murray* applied to the maintenance component because the Taxpayer might have to repay the maintenance component if it did not meet its maintenance obligations and was successfully sued for damages. However, unlike the fees in *Arthur Murray*, the maintenance component was not a prepayment for services. As such, *Arthur Murray* was not authority for the view that the maintenance component was subject to a contingency of repayment in the event the Taxpayer was successfully sued for damages.

6 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.

7 Section 149A(2) of the TAA.

8 Section 149A(1) of the TAA.

9 *Buckley & Young Ltd v CIR*.

10 *Firm PI 1 Ltd v Zurich Australian Insurance and Body Corporate 398983* [2014] NZSC 147, (2014) 10 NZBLC 99716. See also *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, (2010) 9 NZBLC 102,874 and *Pendarves Packaging Ltd v Baitworx Ltd* [2014] NZHC 3,327, (2015) 1 NZBLC 99–718.

11 The approach to contract interpretation was no different in tax cases. In *CIR v John Curtis Developments Ltd* [2014] NZHC 3,034, 26 NZTC 21-113 Kos J said that for tax purposes the contract underlying a transaction must be construed in the ordinary way.

12 *Arthur Murray (NSW) Pty Ltd v FCT* (1965) 14 CLR 314 (HCA).

Mitsubishi (CA)

24. The Taxpayer relied on the Court of Appeal decision in *Mitsubishi* (***Mitsubishi* (CA)**).[13] In *Mitsubishi* (CA) customers purchased a car that came with the benefit of a warranty against defects. Although customers obtained two things under their sale contracts (a car and a warranty), the contract price was expressed to be a payment for a car only. The Court of Appeal found that it was permissible to apportion a part of the sale price to the warranty. In *Mitsubishi* (***Mitsubishi* (PC)**) the Privy Council rejected this approach.[14] Lord Hoffman said that if Mitsubishi had made a separate charge for the warranty there would be no difficulty in treating that income as earned over the warranty period rather than at the moment of sale. However, there was no justification in the accounting evidence for retrospectively treating part of the sum agreed to be the price of a car as if it had been a separate charge for a warranty.
25. The Taxpayer argued that the Privy Council's decision in *Mitsubishi* (PC)) was distinguishable because Mitsubishi did not have a sound basis for identifying the amount of income that related to the warranties. However, the Tax Counsel Office considered that this argument was incorrect because the Taxpayer's customers did not obtain maintenance services. Therefore, although it was possible to calculate the maintenance component, there was nothing under the contractual arrangements that this amount could be apportioned to. For this reason, there was no basis for the type of apportionment contemplated by the Privy Council in its judgment in *Mitsubishi* (PC).

The accounting evidence

26. The Courts have held that financial reporting standards and commercial accounting practice have some relevance in determining when income is derived but they are not determinative and will always be subject to the statutory scheme and the most appropriate approach for income tax purposes.[15]
27. The approach under tax law principles to determining the time at which the maintenance component was derived was different from the approach that the Taxpayer adopted when determining the extent to which the maintenance component should be recognised for accounting purposes under NZ IFRS 15.
28. As such, the Taxpayer's accounting treatment was inconsistent with relevant tax law principles. Therefore, as a taxpayer's accounting treatment was not determinative and was subordinate to the most appropriate tax law treatment (if inconsistent with that treatment), the Taxpayer's approach under NZ IFRS 15 did not support the tax treatment that it proposed in relation to the rental under the leases.

The commercial context

29. The Taxpayer argued its position was consistent with the commercial reality of the arrangements under the leases. However, as the tax consequences of a transaction turn on the legal arrangements actually entered into and carried out, the Taxpayer's approach could not be adopted for assessment purposes, even if it was thought to be consistent with the underlying commercial reality of the lease arrangements.
30. In any event, there was a measure of consistency between the commercial and legal substance of the lease transactions. The apparent commercial purpose of the leases was to provide customers with a leasing option under which responsibility for repairing and maintaining a leased asset remained with the Taxpayer. To this end the Taxpayer scheduled those activities (in so far as they could be planned), paid for them, and took responsibility for approving designated servicing agents. Conversely, the customer paid a single amount of rental for the hire of an asset and to the extent that the customer had any maintenance responsibilities, it met those responsibilities at its own cost. These matters went to the commercial reality of the leases and were consistent with the legal substance of the transactions, in that:
    - the rental the customers paid under the leases was consideration for the hire of an asset in good repair and operating condition, and
    - the rental was not to any extent a payment for maintenance services.

13 *CIR v Mitsubishi Motors New Zealand Ltd* (1994) 16 NZTC 11,099 (CA).

14 *CIR v Mitsubishi Motors New Zealand Limited* (1995) 17 NZTC 12,351 (PC).

15 *Horizon Homes Limited v CIR* (1994) 16 NZTC 11,064 (HC) at 11,069-11,070.

Issue 2 | Take tuarua: When is the Taxpayer entitled to deduct the maintenance expenditure?

31. As noted above at [10], the Taxpayer argued in the alternative that, if it was wrong and the maintenance component of the rental under the leases was derived on a current year basis, it was entitled to deduct maintenance expenditure up to the value of the maintenance component derived in each income year.

When does the Taxpayer incur the maintenance expenditure?

32. Under *Mitsubishi* (PC), expenditure was incurred if there was an existing legal obligation to make a payment in the future and the obligation was one to which the person was definitively committed. The Taxpayer considered that it incurred maintenance expenditure at the time the lease was entered into because that was the time at which it became liable to carry out scheduled and unscheduled maintenance, and the cost of meeting that liability could be reliably estimated. The Taxpayer placed reliance on similarities between:
    - its maintenance responsibilities, and
    - the warranty arrangements in Mitsubishi (PC) and free servicing arrangements which are discussed in Interpretation Statement "*Meaning of Incurred – The Privy Council Decision in the Mitsubishi Case Interpretation Statement* – IS3533".
33. Although there were similarities, there were also material differences. Vendors of assets under free servicing and warranty arrangements supplied services to the purchasers of the assets because the purchasers owned the assets. In contrast, when the Taxpayer carried out scheduled and unscheduled maintenance it was not providing services to its customers under the leases because it did not have a contractual obligation to do so. Instead, the Taxpayer's obligation was to provide an asset that was in good repair and operating condition. Since the Taxpayer was not contractually liable to provide repair and maintenance services, it was not possible to conclude that at the time a lease was entered into, an obligation to make payments meeting such liability had accrued. Consequently, the Tax Counsel Office considered the facts of the present matter were distinguishable from the material facts in *Mitsubishi* (PC) with the result that the Taxpayer's argument could not succeed.

Scheduled and unscheduled maintenance

34. There were additional circumstances that supported a conclusion the Taxpayer's maintenance responsibilities did not constitute an existing obligation to carry out scheduled and unscheduled maintenance at the time a lease was entered into:

    Scheduled maintenance:

    - It was implicit that the Taxpayer was not under a contractual obligation to its customers to perform each item of scheduled maintenance. This was supported by the fact the Taxpayer's maintenance obligation was to maintain each asset in good repair and operating condition.
    - It followed that there was no underlying legal obligation on the Taxpayer to perform the scheduled maintenance to which it could be said the Taxpayer was definitively committed (*Mitsubishi (PC)).*

    Unscheduled maintenance:

    - If a part in a leased asset failed prematurely, any failure by the Taxpayer to replace the part could constitute a breach of the Taxpayer's obligation to ensure the asset was kept in good repair and operating condition. However, this did not show that the cost of replacing the part was incurred at the time the lease was entered into. For that to be the case, the Taxpayer's liability to replace the part must have been in existence at that time. This would require that the defective part was in the asset at the time the lease was entered into with the consequence that the asset was not in a state of good repair and operating condition.
    - However, it had not been shown this was the case. The leases were typically entered into for a number of years, in contrast to the warranty period in *Mitsubishi* being limited to 1 year or 20,000km. Further, the Taxpayer had not provided any evidence to justify its assertion that any unscheduled maintenance arose due to defects that were inherent in the assets on the day the leases were entered into.
    - It followed that in the context of unscheduled maintenance the Taxpayer had not satisfied the burden of proving that asset parts requiring replacement were inherently defective at the time the leases were entered into.

Matching of income and expenditure

35. If the Taxpayer was treated as being under an obligation to provide repair and maintenance services at the time a lease was entered into, the end result would be inconsistent with the reasoning in *Mitsubishi* (PC). *Mitsubishi* (PC) was concerned with the matching of expenditure and income. The costs that vendors under warranty and free servicing arrangements paid to meet their obligations to purchasers related wholly to sales income that was derived in the year of the sale. Matching of that nature would not occur if the costs the Taxpayer paid carrying out scheduled and unscheduled maintenance were treated as incurred in the year an applicable lease was entered into. This was because the income that was payable under the leases arose over the term of the lease and not only in the year the lease was entered into. This was a further point of distinction from *Mitsubishi* (PC).

Section EA 3

36. Although it was concluded that the Taxpayer did not incur maintenance expenditure when it entered into the leases, it was observed that if this conclusion was incorrect and it was found that the Taxpayer did incur the maintenance expenditure at that time, s EA 3 would likely apply to the expenditure.

37. Section EA 3 applies when a person has been allowed a deduction for expenditure and the expenditure is unexpired at the end of the person's income year. Expenditure on services is unexpired at the end of an income year if the services have not been performed by the end of the year. Therefore, as the maintenance expenditure was expenditure that would be paid in the acquisition of services from third parties, the maintenance expenditure would be unexpired at the end of any income year to the extent that the services for which the expenditure was payment have not been provided.

38. Section EA 3 requires a person to add the unexpired portion of their expenditure at the end of an income year to their income for the year and then allows the person to claim the portion as a deduction in the following year. In practical effect, therefore, the Taxpayer would be required to defer its deduction for the maintenance expenditure to the year or years in which the services to which the expenditure relates were performed.