Vol 35 No 5 June 2023

TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

ISSN 1177-620X (Online)

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
2023-24 work programme	Public guidance work programme	Public advice and guidance work programme 2023-24	6 June 2023
PUB00397-1	QWBA	Income tax – bright-line test – main home exclusion – renting to flatmates	13 June 2023
PUB00397-2	QWBA	Income tax – deductibility of expenditure – renting to flatmates	13 June 2023
PUB00423	Interpretation statement	GST - Court awards and out-of-court settlements	14 June 2023
PUB00389	Interpretation statement	Goods and Services Tax – Unit title body corporates	20 June 2023

IN SUMMARY

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NEW LEGISLATION

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

Order in Council - Tax Administration (Extension of Due Dates) Order 2023

Section 226 of the Tax Administration Act 1994

Order

The Tax Administration (Extension of Due Dates) Order 2023 was made on 11 April 2023 and came into force on that day.

The Order extended the time for taxpayers to meet two statutory time frames:

- Make a payment of income derived by a trustee of a trust in the income year to a beneficiary of the trust in the income year in order for the income to be treated as beneficiary income, and
- Write off a debt as bad in the income year in order for a deduction to be made available to them in the tax year.

Background

Between 8 January 2023 and 3 February 2023, a series of fronts crossed the upper North Island delivering extremely heavy rain, high winds, and widespread flooding in the Auckland, Bay of Plenty, Northland, and Waikato regions. Then, between 12 February and 16 February 2023, Cyclone Gabrielle moved across the North Island, also resulting in heavy rain, high winds, and flooding.

These weather events have impacted taxpayer's businesses and livelihoods. To support impacted taxpayers to meet their tax obligations at this time, the Order extends two statutory time frames relating to payments of beneficiary income and bad-debt deductions.

Key features

The Tax Administration (Extension of Due Dates) Order 2023 extends two statutory time frames for taxpayers whose ability to adhere to the time frames is significantly adversely affected by any of the following severe weather events:

- Cyclone Hale, which occurred from 8 January 2023 to 12 January 2023
- heavy rainfall in the Northland, Auckland, Waikato, and Bay of Plenty regions, which occurred from 26 January 2023 to 3 February 2023, and
- Cyclone Gabrielle, which occurred from 12 February 2023 to 16 February 2023.

The following extensions of time are available to impacted taxpayers:

- For income derived in the 2021–22 income year, taxpayers have until 31 May 2023 to make a payment of income derived by a trustee of a trust to a beneficiary of the trust in order for the income to be treated as beneficiary income.
- For the 2022–23 income year, taxpayers have until 31 May 2023 to write off a bad-debt in order for a deduction to be made available to them in the tax year.

The Order is made under section 226 of the Tax Administration Act 1994. That section allows for extensions of time to be granted to meet requirements under some of the Inland Revenue Acts, even if the deadline has already expired.

Effective date

The Order came into force on 11 April 2023.

Further information

The new regulations can be found at:

https://www.legislation.govt.nz/regulation/public/2023/0048/7.0/whole.html#LMS828397

OPERATIONAL STATEMENTS

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

OS 23/01: When employee allowances for additional transport costs for home to work travel are exempt from income tax

Operational Statements set out the Commissioner of Inland Revenue's (the Commissioner's) view of the law and deal with practical issues arising out of the administration of the Inland Revenue Acts.

This Statement covers when employee allowances for additional transport costs for home to work travel are exempt from income tax under s CW 18.

All legislative references in this Statement are to the Income Tax Act 2007, unless specified otherwise.

Introduction

1. Payments an employer makes for a private expense of an employee are usually subject to income tax in the hands of the employee.
2. The general rule is that home-to-work travel is private expenditure as it is expenditure to get to work and reflects the employee's personal choice about where their home is. The two main reasons for this rule are that the:
   - employee's private choices (about where to live and how to get to work) are the key factor in determining the cost of home-to-work travel.
   - expense of starting work is distinguished from expenses while "on work", and employees are expected to bear the cost of starting work.
3. As this expenditure is usually private, if the employer provides the employee with an allowance for travel from home to work, the starting point is that it is taxable.
4. If an allowance is taxable for income tax purposes, then the employer must deduct and pay PAYE for that payment. This is because the allowance is "salary or wages" under the PAYE rules.
5. However, s CW 18 exempts from tax some allowances that an employee receives from their employer to reimburse additional transport costs arising from the employee's travel from home to work (the additional transport costs exemption). This means that PAYE does not have to be deducted from the allowance.
6. The purpose of this Statement is to clarify when this exemption applies and to help employers to determine the amount of tax payable.
7. It includes examples for further clarification.

> Recent changes mean that FBT does not apply to certain public transport fares that an employer subsidises. Employers who provide subsidised public transport to employees can find further information at Employer provided unclassified fringe benefits (**ird.govt.nz**)

> Employers also often provide travel for their employees from home to a distant workplace. These employers may find it useful to refer to the Commissioner's position on employer-provided travel: OS 19/05: *Employer-provided travel from home to a distant workplace – income tax (PAYE) and fringe benefit tax* (Inland Revenue, 2019).

Summary of approach

8. The Commissioner considers that three main steps are needed to determine the extent to which the additional transport costs exemption applies to an allowance an employer pays to an employee for travel from home to work:
   - *Step One* – Are one or more of the factors present that are required for the exemption to additional transport costs to apply? If none of these factors is present, then the additional transport costs exemption cannot apply.

- *Step Two* – Did the employee incur the additional transport costs in connection with their employment and for the employer's benefit or convenience?
- *Step Three* – How much of a travel allowance is exempt under the additional transport costs exemption? Calculate the additional transport costs and compare them with the allowance paid.

Definitions

9. Key terms in this Statement have the following definitions:
   - **Additional transport costs** are costs to an employee of travelling between their home and place of work that are more than would ordinarily be expected. (See also [11].)
   - **Additional transport costs exemption** means the exemption from income tax for some allowances an employer pays for the employee's cost of home-to-work travel provided for in s CW 18.
   - **Home** means a dwelling the employee uses as their residence.
   - **Travel allowance** means an allowance an employer pays to an employee (or a group of employees) to reimburse them for their travel between home and work.
   - **Workplace** means a particular place or base:
     - where an employee performs their employment duties; or
     - from which an employee's duties are allocated.

     This means that a workplace is not confined to premises of the employer. It can be where the employee performs employment duties, which could be a client's premises.[1]

Discussion

When does the additional transport costs exemption apply?

10. A travel allowance will be exempt under the additional transport costs exemption in s CW 18 **to the extent that:**
    - the allowance reimburses the employee for their additional transport costs; and
    - the employee incurred those transport costs in connection with their employment and for the employer's benefit or convenience.
11. "**Additional transport costs"** are costs to an employee of travelling between their home and place of work that are more than would ordinarily be expected. The costs must be attributable to one or more of the following factors:[2]
    (a) the day or time of day when the work duties are performed:
    (b) the need to transport any goods or material for use or disposal in the course of the employee's work:
    (c) the requirement to fulfil a statutory obligation:
    (d) a temporary change in the employee's place of work while in the same employment:
    (e) any other condition of the employee's work:
    (f) the absence of an adequate public passenger transport service that operates fixed routes and a regular timetable for the employee's place of work.
12. The Commissioner considers that three main steps determine the extent that the additional transport costs exemption applies to an allowance an employer pays to an employee for travel between home and work:
    - *Step One* – Are one or more of the factors ((a) to (f)) present that are required for the exemption to apply? If none of the factors is present, then the additional transport costs exemption cannot apply.
    - *Step Two* – Did the employee incur the transport costs in connection with their employment and for the employer's benefit or convenience?

1 The question of whether a client's premises would qualify as workplace for these purposes is a question of fact and degree. It is intended to address situations where the employee's work pattern is such that they are effectively working from, and based at, the client's premise for a period of time. Most situations where employees merely visit client's premise will not suffice.

2 Section CW 18(3).

- *Step Three* – How much of a travel allowance is exempt under the additional transport costs exemption? Calculate the additional transport costs and compare them with the allowance paid.

Step One – Are one or more of the factors present that are required for the exemption to apply?

13. As one or more of the factors listed in s CW 18 must be present for the additional transport costs exemption to apply, an employer's first step is to determine whether any of these factors are present.
14. Each of these factors ((a) to (f)) is discussed in turn below.

Factor (a): The day or time of day when the work duties are performed

15. For this factor to apply, the additional transport costs must be attributable to:
    - the time or times of the day, or
    - the day (or days) of the week

    that the employee was required to perform the duties of that employment (Example 1).

> **Example 1: Factor (a) applies**
>
> Employees of a restaurant start their shift at 4 pm and finish after midnight. Public transport serves the place of work at 4 pm but stops at 11 pm. The employees need alternative transport home that will usually cost more than public transport.[3]

> **Example 2: Factor (a) applies**
>
> Jake is an employee of the city council who starts their shift at 7am and finish at 7pm. On Sunday public transport serves Jake's work but only after 7am. Jake needs to take alternative transport to work that usually costs more than public transport.

Factor (b): The need to transport any items for use or disposal in the course of the employee's work

16. This factor will apply if, as part of their job, the employee is required to use a particular type of transport (which they provide or pay for) to move any of the following items:
    - plant,
    - machinery,
    - equipment,
    - technical aids,
    - goods, or
    - material.
17. The employee must move those items, as part of their job, for use or disposal (Example 3).

> **Example 3: Factor (b) applies**
>
> Harlie is an assistant garage door installer in a provincial city. Being environmentally conscious, she prefers to use her e-bike to get to work. Occasionally, however, her employer needs her to collect a scissor lift from a hire centre for use on that day. On those days, Harlie needs to use her motor vehicle to collect the scissor lift on the way to work.
>
> Harlie's employer pays her an allowance to recognise the additional costs she incurs because she needs to use her motor vehicle on those days.

Factor (c): Fulfilling an obligation under any Act

18. This factor will apply if an employee incurs the transport costs in fulfilling an obligation that arises under any Act. The Commissioner considers that this factor will also apply to regulations issued under any Act.

3 If the employee needs to use their personal car to travel home from work as no public transport is available, then the additional cost of driving that car to work will be part of the cost. to be taken into account in determining any additional transport costs.

19. Importantly, this provision does not apply simply because an Act provides for a travel allowance to be paid to certain employees. While the employer is fulfilling a statutory obligation by paying the allowance, **the employee must incur additional transport costs** in fulfilling a statutory obligation before this factor applies (Example 4).

> **Example 4: Factor (c) applies**
>
> Due to the nature of her employment Penelope is required to get a COVID-19 test every week under a Public Health Order. She usually travels to work by public transport but cannot use public transport to get the COVID-19 test.
>
> One day a week Penelope takes her car to work so she can get tested on the way.
>
> Penelope's employer pays her an allowance to recognise the additional costs she incurs because she needs to use her car on that day.

Factor (d): A temporary change in the employee's place of work from the normal place of work for the same employer

20. Factor (d) will apply when the employee has a temporary change in their place of work while still working for the same employer.
21. In line with the approach in OS 19/05 (which relates to employer-provided travel from home to a distant workplace), the Commissioner will treat a change in workplace as temporary (for the purposes of determining whether the additional transport costs exemption applies) if that change is for two years or less (Example 5).
22. To treat the change as temporary, the employer must be able to show that the parties reasonably expected the change would be for two years or less. Reasonable expectation is initially measured at the time the requirement for the change arose.
23. Evidence for the parties' expectation may come from the employee's terms of employment. In many cases, however, no written agreement may exist. Other documentation such as board minutes, planning documents and correspondence may demonstrate how long the parties expected the change would be.
24. It is possible that a payment for additional transports costs that is initially treated as non-taxable can become taxable. If it becomes clear that the parties now have a reasonable expectation that the requirement for the employee to change their place of work is no longer temporary (for a period of two years or less), any payment will be taxable from the date the expectation changed (Example 6).[4]
25. Equally, if it becomes clear that a change in location which was expected to be more than a temporary requirement is now expected to be a temporary requirement (a period of two years or less), any payment for additional transport costs can be treated as non-taxable from the date the expectation changed.

> **Example 5: A temporary change in place of work (factor (d)) applies**
>
> Robyn usually works in the Wellington central business district. She is seconded to work in her employer's Lower Hutt branch office for 12 months.
>
> As the secondment is for two years or less (in this case, 12 months), this is a temporary change in her work location. Her employer can treat this travel as temporary.

> **Example 6: A temporary change in place of work (factor (d)) does not apply**
>
> After 11 months of working at the Lower Hutt branch office, Robyn and her employer agree that she will continue to work there for another 16 months.
>
> As the parties now expect that Robyn will be working in Lower Hutt for more than two years (27 months in total), from the date their expectation changed her employer can no longer treat her travel there as temporary.

Factor (e): Any other condition of work of the employee

26. The Commissioner considers that factor (e) has limited application. That is, it refers to "any other condition of the employee's work" that the legislation does not identify **but is similar to the factors the legislation specifically lists.**[5]

4 Not from the end of the original date of the arrangement.

5 Factors (a)–(d) and (f).

27. An employer must be able to explain how the particular condition of work is similar to the factors listed.
28. For the exemption to apply, "any other condition" would have to increase the cost of travelling between an employee's house and their workplace by more than what would be ordinarily expected. It would also have to be for the benefit or convenience of the employer.

Factor (f): The absence of an adequate public passenger transport service that operates fixed routes and a regular timetable for the employee's place of work

29. Factor (f) applies when no public passenger transport service serves an employee's **place of work** (Example 7). To qualify as servicing the place of work, the public transport service must operate fixed routes and a regular timetable that service the employee's place of work (Example 8).
30. It is important to note that whether a public passenger transport service serves an employee's home does not determine whether their **place of work** is serviced by an adequate public transport service.

> **Example 7: No public transport service – factor (f) applies**
>
> Rosie's employer is based 10 kilometres outside Masterton. Although a bus network serves Wairarapa, it does not provide services near Rosie's workplace.
>
> In this example, no public transport service serves Rosie's workplace and factor (f) applies.

> **Example 8: A public transport service operates – factor (f) does not apply**
>
> The bus network provides a regular, timetabled service to Rosie's employer but it does not go near her house.
>
> In this example, a public transport service serves Rosie's workplace so factor (f) does not apply.

31. The Commissioner considers that where the public transport services available do not neatly fit with an employee's hours of work, that does not in itself mean that the public transport service is inadequate.
32. The Commissioner considers that this factor will apply when a workplace:
    - has no public transport service at all;
    - has no public transport service available to shift workers;
    - clearly has more employees starting work at one time than public transport can accommodate; or
    - is not close to the nearest bus, train or ferry stop.[6]

Step Two – Did the employee incur the additional transport costs in connection with their employment and for the employer's benefit or convenience?

33. The Commissioner accepts that where an employee incurs additional transport costs as a result of one of the listed factors, they will incur those costs in connection with their employment.
34. This means that the key question to answer at Step Two is whether the employee incurred the costs for the employer's benefit or convenience.
35. This means that, for any allowance to be exempt, one of the factors (a) to (f) must arise from the nature of the employment or a need or requirement of the employer (Example 9).
36. It cannot arise for the benefit or convenience of the employee.

> **Example 9: Employee incurs transport costs for employer's benefit or convenience**
>
> Mikaere usually works in the Christchurch CBD. Due to staff shortages, he is seconded for six months to work at his employer's branch office located at Christchurch Airport.
>
> As this temporary change in work location arises from a need of the employer, it is for the employer's benefit or convenience and the additional transport costs exemption can apply.

6 Historically, Inland Revenue has considered that a workplace that is located within 1.6km walking distance of the nearest bus or train or ferry stop is close to the nearest stop.

Example 10: Employee incurs transport costs for their own benefit or convenience

What if the change was made because Mikaere asked for a temporary change in location due to his personal circumstances rather than because of staff shortages?

In that case, the temporary change arises from Mikaere's personal need, so the change is for his benefit or convenience not his employer's. This means that the additional transport costs exemption cannot apply.

Step Three – How much of a travel allowance is exempt under the additional transport costs exemption?

37. The amount of the allowance that is exempt from income tax is the amount that relates to the additional transport costs.
38. This means that to determine how much of any travel allowance is exempt, an employer must identify what those additional costs are. Then the employer must compare the total amount of the allowance paid with the additional transport costs to determine how much of the allowance is exempt.
39. If the additional transport costs the employee incurred are less than the total allowance, only the amount that is equal to the additional transport costs is exempt.
40. If the additional transport costs the employee incurred are equal to or greater than the actual allowance paid, the entire allowance is exempt.

Calculating any additional transport costs: factors (a) to (e)

41. When any of factors (a) to (e) apply (but not (f)), the additional costs are the amount by which the costs are more than the travel costs the employee would ordinarily expect without reference to that factor.
42. This means that the amount of the additional transport costs is not the total transport costs. Rather, it is the **total** transport costs **less** the costs the employer would have "expected to find" the employee incurred "in the ordinary course of events" if the factors that caused the employee to incur the "additional" travel costs did not apply (Examples 11 and 12).

Example 11: Calculating additional transport costs where costs are higher than ordinarily expected

Robyn works in the Wellington CBD. She is seconded to work in her employer's Lower Hutt branch office for 12 months.

Normally, Robyn's costs of getting to work involve a return bus trip with a weekly cost of $30. But this temporary change in work location requires her to take the train as well at the cost of an additional $43 a week.

The **additional transport cost** per week is $43. Any allowance up to $43 will be exempt.

Example 12: Costs must be higher than ordinarily expected

Bob (a builder) works for a company whose depot is in Seaview in Lower Hutt, but he rarely visits the depot. Instead, he travels directly to various building sites. Most of the sites are in the Wellington CBD but from time to time his employer sends him to building sites in other parts of the Wellington region.

The fact that an employee may be working at multiple sites in a geographic area will not be relevant to the s CW 18 exemption if the costs of travel to those diverse sites are not more than would ordinarily be expected.

However, if the employer decided that Bob was needed to work in Featherston (in the Wairarapa region), that might be a temporary change in the place of work that would lead to higher than ordinary costs. In that way, the costs could come within the s CW 18 exemption.

Calculating any additional transport costs – factor (f): lack of public transport

43. When the employee incurs the additional transport costs because of a lack of public transport services (see [29]), the additional transport costs are the amount by which the costs are more than $5 for each day on which the employee attends work (Example 13).

Example 13: Calculating additional transport costs where no public transport is available

There is no public transport service to Rosie's workplace so factor (f) applies. Rosie incurs transport costs of $60 a week getting to work for a five-day working week. In this example, the **additional transport cost**s are $35 ($60 – (5 × $5)).

Any allowance paid to Rosie for additional transport costs up to $35 will be exempt.

If Rosie was paid the entire $60, $35 would be exempt and $25 would be subject to tax.

Limit of 70 kilometres a day

44. There is a limit on what travel an employer can take into account in calculating additional transport costs.
45. An employer should not take into account the costs of travelling any distance **over** 70 kilometres in 1 day in calculating additional transport costs. This means that, to the extent that the allowance is exempt because it is for additional transport costs, the exemption is limited to the costs for travelling up to 70 kilometres in 1 day.
46. However, in special circumstances, an employer **does include** the costs of travelling any distance over 70 kilometres in 1 day in calculating additional transport costs.
47. The phrase "except in special circumstances" means that those circumstances are set apart from the usual case. It covers exceptional, abnormal or unusual and is not limited to extraordinary or unique cases.
48. It is important to understand that the simple fact that an employee has to travel more than 70 kilometres between work and home is **not** a "special circumstance" (Example 14).
49. Given the obligation is on the employer to assess whether there are special circumstances justifying exempting additional transport costs for distances over 70 kilometres per day, the employer needs to be able to demonstrate that the circumstances meet the statutory test of "special circumstances" (Example 15).
50. The special circumstances must arise from the location of the workplace rather than where the employee chooses to live.

Example 14: Special circumstances do not apply

Paullina lives in Waikanae but is working in Wellington (60 kilometres one way, and 120 kilometres return). Her employer pays her an allowance to meet the transport costs of getting to work in Wellington.

To the extent that the allowance is exempt because it is for additional transport costs, the exemption is limited to the costs for travelling 70 kilometres in 1 day. The costs for the additional 50 kilometres of travel per day are not exempt unless special circumstances exist.

"Special circumstances" do not exist **ju**st because Paullina's daily commute is longer than 70 kilometres.

Example 15: Special circumstances do apply

Barry works in a national park where there is no accommodation. Barry lives in the nearest town, which is more than 50 kilometres away. His round trip each day between that accommodation and his workplace is more than 70 kilometres.

In this example, special circumstances exist because no one (including Barry) could live any closer to his workplace.

However, these "special circumstances" would not exist just because Barry's daily commute is longer than 70 kilometres.

Additional transport costs – estimated expenditure of employees

51. In determining the additional transport costs, the employer may make a reasonable estimate of the amount of expenditure the employee or a group of employees is likely to incur for which they can receive reimbursement.
52. In calculating the additional transport costs involving the use of a motor vehicle, an employer can use the approach in OS 19/04b: *Commissioner's statement on using a kilometre rate for employee reimbursement of a motor vehicle* (Inland Revenue, 2019) to make a reasonable estimate of the costs the employee is likely to incur (Example 16).

Example 16: A reasonable estimate of the costs the employee is likely to incur

There is no public transport service to Rosie's workplace, so factor (f) applies. Rosie uses her car to get to work each day. The total distance she travels each working day is 40 kilometres.

This equates to 200 kilometres a week. The employer could use the Tier One rate for the cost per kilometre estimate of expenditure.

So each week[7] Rosie's additional transport costs are 200 × 83 cents, which equals $166. Then the employer subtracts $25[8] to arrive at **additional transport costs** of $141.

Any allowance paid to Rosie for additional transport costs up to $141 will be exempt.[9]

53. In making a reasonable estimate for a group of employees, the employer should use a system that groups "like" employees together. (In this way, any exemption can be related to a fair and reasonable estimate of costs the employees incur.)

What if circumstances change?

54. If circumstances change, then the extent to which any allowance is exempt may change.

55. For example, in some cases, as the result of a change in circumstances, none of the factors required for an exemption may be present anymore. If the employer continues to pay the allowance in such a case, none of that allowance would be exempt.

56. The Commissioner is aware that in some situations, employers are continuing to treat an allowance for additional transport costs as tax exempt even when an employee no longer incurs those costs on every working day (because the employee now works from home). The allowance is only exempt to the extent it is for additional transport costs. An employer will need to adjust the amount treated as exempt under the additional transport costs exemption to reflect the change in circumstances.

What if an employee is required to enter into a salary sacrifice to receive the allowance?

57. If an employee can only receive an allowance for additional transport costs by entering into a salary sacrifice arrangement, then the Commissioner considers that the allowance does not truly reimburse the employee for those costs. As such, the employer should not treat the allowance in question as exempt under the additional transport costs exemption. Rather, they should treat it as a taxable allowance with PAYE deducted.

This Statement was signed on 03 May 2023.

Matthew Evans

Technical Lead

Legal Services – Technical Standards

7 Based on 2022 rates in OS 19/04 (KM 2022) : "Kilometre rates for the business use of vehicles for the 2022 income year."

8 5 × $5 per day non-exempt amount.

9 If Rosie was a part-time worker the calculation would need to reflect the number of days travelled to work in that situation.

References

Legislative references

Income Tax Act 2007, s CW 18

Other references

OS 19/04 (KM 2022): *Kilometre rates for the business use of vehicles for the 2022 income year (Inland Revenue 2022).* https://www.taxtechnical.ird.govt.nz/operational-statements/2022/os-19-04-km-2022

OS 19/04b: *Commissioner's statement on using a kilometre rate for employee reimbursement of a motor vehicle (Inland Revenue, 2019).* https://www.taxtechnical.ird.govt.nz/operational-statements/os-1904-b-commissioner-s-statement-on-using-a-kilometre-rate-for-employee-reimbursement-of-a-motor-v

OS 19/05: *Employer-provided travel from home to a distant workplace – income tax (PAYE) and fringe benefit tax (Inland Revenue, 2019).* https://www.taxtechnical.ird.govt.nz/operational-statements/os-1905-employer-provided-travel-from-home-to-a-distant-workplace-income-tax-paye-and-fringe-benefit

Appendix: Section CW 18 of the Income Tax 2007

CW 18 Allowance for additional transport costs

Exempt income

(1) An allowance that an employee receives from an employer to reimburse the employee's additional transport costs is exempt income to the extent to which the employee incurs the costs in connection with their employment and for the employer's benefit or convenience.

Estimated expenditure of employees

(2) For the purposes of subsection (1),—

(a) the employer may make, for a relevant period, a reasonable estimate of the amount of expenditure likely to be incurred by the employee or a group of employees for which reimbursement is payable; and

(b) the amount estimated is treated as if it were the amount incurred during the period to which the estimate relates.

Meaning of additional transport costs

(3) In this section, additional transport costs means the costs to an employee of travelling between their home and place of work that are more than would ordinarily be expected. The costs must be attributable to 1 or more of the following factors:

(a) the day or time of day when the work duties are performed:

(b) the need to transport any goods or material for use or disposal in the course of the employee's work:

(c) the requirement to fulfil a statutory obligation:

(d) a temporary change in the employee's place of work while in the same employment:

(e) any other condition of the employee's work:

(f) the absence of an adequate public passenger transport service that operates fixed routes and a regular timetable for the employee's place of work.

Quantifying additional transport costs

(4) Additional transport costs are quantified as follows:

(a) when the additional transport costs are attributed to a factor described in any of subsection (3)(a) to (e), the amount by which the costs are more than the employee's ordinarily expected travel costs without reference to that factor:

(b) when the additional transport costs are attributed to the factor described in subsection (3)(f), the amount by which the costs are more than $5 for each day on which the employee attends work:

(c) except in special circumstances, the costs of travelling any distance over 70 kilometres in 1 day are not taken into account in calculating additional transport costs.

OS 19/04 (KM 2023) Kilometre rates for the business use of vehicles for the 2023 income year

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

The rates set out below apply for the 2022/2023 income year for business motor vehicle expenditure claims. The tier one rates reflect an overall increase in vehicle running costs largely due to fuel costs and interest rates.

The table of rates for the 2023 income year:

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

Vehicle Type	Tier One Rate	Tier Two rate
Petrol or Diesel	95 cents	34 cents
Petrol Hybrid	95 cents	20 cents
Electric	95 cents	11 cents

Operational Statements OS 19/04A: *Commissioner's statement on using a kilometre rate for business running of a motor vehicle - deductions* and *OS 19/04B: Commissioner's statement on using a kilometre rate for employee reimbursement of a motor vehicle* provide further information on the use of the kilometre rates.

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.

2023 Consumers Price Index adjustment to standard-cost amounts for household services (childcare, boarding services, or short-stay accommodation)

In accordance with Section 91AA of the Tax Administration Act 1994, the Commissioner advises adjustments have been made to the standard-cost amounts for the 2023 income year (1 April 2022 to 31 March 2023), as follows:

Determination DET 09/02 (CPI 2023) Childcare household service

- Hourly standard cost (per child)	$4.30
- Annual fixed administration and record keeping standard-cost	$418.00

Determination DET 19/02 (CPI 2023) Household boarding service providers

- Weekly standard-cost (per boarder)	$222.00

Determination DET 19/02 (CPI 2023) Short-stay accommodation

- daily standard-cost (for each guest)	
Owned dwelling	$59.00
Rented dwelling	$53.00

These amounts reflect the annual movement of the Consumers Price Index for the twelve months to March 2023, which showed an increase of 6.7%.

2023 Adjustment to the Square Metre Rate amount

In accordance with Section DB 18AA of the Income Tax Act 2007, the Commissioner advises that the square metre rate for the 2023 income year (1 April 2022 to 31 March 2023) is set at $51.05. The amount reflects the most recent Household Economic Survey utility costs sourced from Statistics New Zealand (in 2019) adjusted annually for inflation, with the annual movement of the Consumers Price Index for the twelve months to March 2023, being 6.7%.

Operational Statement 19/03 provides further information on the use of the square metre rate.

INTERPRETATION STATEMENTS

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

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

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

IS 23/02: Income tax – Application of the s CZ 39 5 year bright-line test to certain family and close relationship transactions

This interpretation statement considers the requirements of the 5 year bright-line test for residential land in s CZ 39 of the Income Tax Act 2007 and how it applies to certain family and close relationship transactions. Those family and close relationship transactions are when the ownership of residential land (that is not a main home) changes from:

- parents to their child to assist the child with buying their first home;
- one partner to themselves and their new partner; and
- all the beneficiaries who inherit the land under a will or rules of intestacy to some of the beneficiaries.

The bright-line test under s CZ 39 applies if a person first acquired an estate or interest in residential land on or after 29 March 2018 but before 27 March 2021.

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

Summary | Whakarāpopoto

1. Sections CB 6A and CZ 39 provide for objective "bright-line" tests for the disposal of residential land. The application dates of the sections are generally as follows:
   - Section CB 6A, as originally enacted, applied if a person first acquired an estate or interest in residential land on 1 October 2015 to 28 March 2018 (inclusive).[1] The bright-line period was originally 2 years.
   - Section CZ 39 applies if a person first acquired an estate or interest in residential land on 29 March 2018 to 26 March 2021 (inclusive).[2] The bright-line period is 5 years.
   - Section CB 6A was replaced and now applies if a person acquired an estate or interest in residential land on or after 27 March 2021.[3] The bright-line period is either 10 years or 5 years (for new builds).
2. This Interpretation Statement focuses only on the application of s CZ 39 in the context of certain family and close relationship transactions. The test under s CZ 39 requires income tax to be paid on amounts derived from the disposal of residential land acquired and disposed of within the bright-line period of 5 years.
3. The Commissioner has been asked whether the s CZ 39 bright-line test applies to family and close relationship transactions where the ownership of residential land (that is not a main home) changes from:
   - parents to their child to assist the child with buying their first home;
   - one partner[4] to themselves and their new partner; and
   - all the beneficiaries who inherit the land under a will or rules of intestacy to some of the beneficiaries.

1 Section 4(2) of the Taxation (Bright-line Test for Residential Land) Act 2015.

2 Section CZ 39(1).

3 Section 48(2) of the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022. The application of s CB 6A is covered in detail in New legislation: Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022, Bright-line test changes, *Tax Information Bulletin* Vol 34, No 5 (June 2022): 3 at 119–148.

4 "Partner" in this statement means spouse, civil union partner or de facto partner; it does not mean a partner in a partnership.

4. All requirements of s CZ 39 need to be met for it to apply to these family and close relationship transactions. A person will have s CZ 39 income if, relevantly:
   - the person first acquires an estate or interest in residential land on or after 29 March 2018 (s CZ 39(1));
   - s CB 6A (Disposal within 10 years: bright-line test for residential land) does not apply;
   - the exclusion for rollover relief under ss CB 6AB, CB 6AC, CB 6AE and FB 3A does not apply;
   - none of ss CB 6 to CB 12 apply;
   - the person derives an amount;
   - the amount is from disposing of residential land;
   - the disposal is within the 5-year bright-line period; and
   - the exception for disposal of land by an executor, administrator or beneficiary does not apply.

Requirements of s CZ 39

Person first acquires an estate or interest in residential land on or after 29 March 2018

5. Section CZ 39 generally applies if a person first acquires an estate or interest in residential land on or after 29 March 2018. In most cases, an estate or interest in residential land is first acquired on the date a binding sale and purchase agreement is entered into (even if some conditions still need to be met).

Section CB 6A does not apply

6. Section CB 6A generally applies if a person acquires an estate or interest in residential land on or after 27 March 2021. This has the effect of s CZ 39 generally applying if a person acquires an estate or interest in residential land on 29 March 2018 to 26 March 2021 (inclusive).

Exclusion for rollover relief does not apply

7. Section CZ 39 does not apply if:
   - any of the rollover relief provisions in ss CB 6AB, CB 6AC, CB 6AE or FB 3A apply; and
   - the transferor (the person who transferred the land to the person now disposing of it) first acquired an estate or interest in the land before 29 March 2018.

None of ss CB 6 to CB 12 apply

8. Sections CB 6 to CB 12 provide that income includes amounts derived from the disposal of land in several situations. Accordingly, s CZ 39 applies only to income from the disposal of residential land that is not already otherwise taxable under these provisions.

Person derives an amount

9. Section CZ 39 applies to a person who derives an amount (from disposing of residential land). The person, for the purposes of s CZ 39 can be an individual, a company, or one or more trustees of a trust.
10. An "amount" includes a monetary sum or money's worth. "Money's worth" refers to consideration given when the property was acquired for something other than money. It means something that is convertible into money, equivalent to money, and is essentially material and capable of being valued.[5]
11. An amount for s CZ 39 purposes may be more than the actual amount derived by the person if the land has been disposed of at below market value, as determined at the time of that disposal (s GC 1 (Disposals of trading stock below market value)). Section GC 1 applies to family and close relationship transactions and deems property transferred below market value to have been transferred at market value.
12. Disposals of property on making a gift or on a trustee's distribution to a beneficiary are also disposals at the market value, occurring at the date of the transaction (s FC 2 (Transfer at market value)).
13. "Market value" is the price that would be agreed between a willing but not anxious seller and a willing but not anxious buyer.
14. An amount has been derived when the earning process in respect of the amount is complete.

5 *Wilkins (Inspector of Taxes) v Rogerson* [1961] 1 All ER 358 (CA) at 361, *Hickman v Turner and Waverley Ltd (formerly Turn and Wave Ltd)* [2013] 1 NZLR 741 (SC) at 747, *Brookfield Multiplex Ltd v International Litigation Funding Partners Pte Ltd* (2009) 260 ALR 643 (FCA) at 685.

Amount is from disposing of residential land

15. Section CZ 39 applies to disposals of "residential land". Residential land must have a dwelling on it, or there must be an arrangement to erect a dwelling on it, or it must be bare land that may be used for erecting a dwelling (s YA 1).
16. Exclusions are farmland and land used predominantly as business premises.
17. "Land" includes an estate or interest in land, including a legal or an equitable estate or interest (s YA 1). An absolute owner holds only the legal estate. An equitable interest, for the purposes of s CZ 39, would include an interest under an off-the-plans contract or an interest of a fixed beneficiary under a trust.
18. The Commissioner considers what is a disposal of land in Interpretation Statement IS 22/03.[6] IS 22/03 concludes that the ordinary meaning, case law and legislative history and context indicate that "disposal" in the land sale rules (including s CZ 39) requires:
    - complete alienation of the land by the disposer – the land must be 'got rid of' by the person;
    - dealing with the land, so that one person loses ownership of the land and another (including the same person in a different capacity) gains it (or gains a corresponding interest in respect of the same underlying land).

    Therefore, in the Commissioner's view, "disposal" in the land sale rules does not include transfers from and to the same person in the same capacity.
19. Gifts are also disposals of land for the purposes of s CZ 39 and so are the transfers on a distribution by trustees of a trust to a beneficiary of the trust.
20. Additionally, due to s CB 23B (Land partially disposed of or disposed of with other land), s CZ 39 applies to disposals of the whole or a part of the interest in land.

Bright-line period is less than 5 years

21. For a transaction to be subject to the s CZ 39 bright-line test, the "bright-line period" has to be less than 5 years. The bright-line period is the period from the "bright-line acquisition date" to the "bright-line date".
22. The "bright-line acquisition date" is generally the date of registration of the transfer of the land to the person or, if there is no date of registration, the latest date on which the person acquired the estate or interest in the land (s CZ 39(2)).
23. Relevant to this statement, the "bright-line date" (s YA 1) is either:
    - the earlier of the date when the person enters into an agreement for the disposal of residential land or makes a gift of residential land; or
    - if there is no such agreement for the disposal or making of a gift, the date on which the person disposes of an estate or interest in the residential land.

Exception for an executor, administrator or beneficiary does not apply

24. An exception from the s CZ 39 bright-line test exists for an amount an executor, administrator or beneficiary derives from disposing of land that was transferred to them on the death of a person.

Family and close relationship transactions

25. The Commissioner concludes that the s CZ 39 bright-line test applies to the following family and close relationship transactions because a person has derived an amount from disposing of residential land (assuming all other requirements of s CZ 39 are met):
    - a disposal from parents, as individuals, to their child;
    - a disposal from a company (which is not a look-through company), where the parents are shareholders, to their child;
    - a disposal from parents, who are the trustees of a trust, to their child who is a beneficiary of the trust;
    - a disposal from one partner to themselves and their new partner, to the extent of the new partner's share in the land;
    - a subsequent disposal from the two partners to a third party; and
    - a disposal from beneficiaries under a will or rules governing intestacy to a third party to the extent that the disposed interests do not equate to (are not the same as) the original shares acquired under a will or rules of intestacy.

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

26. If the amount derived from the disposal is below the market value of the residential land, it is treated as being the market value.
27. However, deductions are allowed under part D for the cost of the residential land, such as acquisition costs and capital improvements (s DB 23 (Cost of revenue account property)) as limited by s EL 20 (Allocation of deductions related to bright-line disposals of residential land)). The deduction is taken in the income year in which the land is disposed of (s EA 2 (Other revenue account property)).
28. Any earlier deductions carried forward under the residential rental ring-fencing rules in subpart EL (Allocation of deductions for excess residential land expenditure) may be allowed to be allocated to the income year under s EL 5 (When residential portfolios sold) or s EL 7 (When Property A sold). Any allowable deductions reduce the amount of income taxable under the s CZ 39 bright-line test.
29. The Commissioner concludes that s CZ 39 does not apply to the following family and close relationship transactions involving residential land:
    - a disposal from parents who are nominees or bare trustees for their child to their child;
    - a disposal from a person who dies to an executor or administrator;
    - a disposal from an executor or administrator to the beneficiaries under a will or rules governing intestacy;
    - a disposal from some of the beneficiaries under a will or rules governing intestacy to the other beneficiaries; and
    - a disposal from beneficiaries under a will or rules governing intestacy to a third party to the extent of their original shares in the land acquired under the will or rules governing intestacy.
30. The outcomes in the scenarios apply regardless of the relationships of the parties.

Introduction | Whakataki

31. The Commissioner has been asked to clarify how the s CZ 39 bright-line test for residential land applies to the following family and close relationship transactions:
    - the ownership of residential land changes from parents to their child to assist the child with buying their first home;
    - the ownership of residential land changes from one partner to themselves and their new partner; and
    - the ownership of residential land changes from all the beneficiaries who inherited the land under a will or rules of intestacy to some of the beneficiaries.
32. The s CZ 39 bright-line test does not apply if the main home exclusion in s CZ 40 applies. The residential land in the family and close relationship transactions considered in this statement is not a main home of the person disposing of it or of a beneficiary of a trust. Therefore, the main home exclusion is not considered in this statement.[7]
33. Section CZ 39 also does not apply to residential land transferred on a settlement of relationship property to which subpart FB applies (see [152]).
34. All the requirements of s CZ 39 need to be met for it to apply to a disposal of residential land. Therefore, this statement first discusses the requirements of s CZ 39, then discusses whether s CZ 39 applies to the family and close relationship transactions listed in [31].

Analysis | Tātari – Requirements of s CZ 39

35. Section CZ 39 relevantly states:

7 See QB 18/16: Income tax – bright-line test – main home exclusion – sale of subdivided section and QB 18/17: Income tax – bright-line test – farmland and main home exclusions – sale of lifestyle blocks.

CZ 39 Disposal within 5 years: bright-line test for residential land: acquisition on or after 29 March 2018

When this section applies

(1) This section applies to a person's disposal of residential land, if the person first acquires an estate or interest in the residential land on or after 29 March 2018 and section CB 6A (Disposal within 10 years: bright-line test for residential land) does not apply. However, this section does not apply to—

(a) a person's disposal of a freehold estate in residential land that the person acquired as the owner of a leasehold estate with a perpetual right of renewal, if the person was granted the leasehold estate before 29 March 2018:

(b) a person's disposal of an estate or interest in residential land that the person acquired as the result of the completion of a land development or subdivision, if before 29 March 2018 the person entered into the agreement under which they acquired the estate or interest upon the completion of the land development or subdivision.

When this section does not apply

(1B) This section does not apply to a person's disposal of residential land if the land meets the requirements of section CB 6AB, CB 6AC, CB 6AE, or FB 3A (which relate to residential land), and the transferor first acquired an estate or interest in the land before 29 March 2018.

Disposal within 5 years

(2) An amount that a person derives from disposing of residential land is income of the person, if the bright-line date for the residential land is within 5 years of—

(a) the date (**the bright-line acquisition date**) on which the instrument to transfer the land to the person was registered—

(i) under the Land Transfer Act 2017; or

(ii) under foreign laws of a similar nature to the Land Transfer Act 2017, if the land is outside New Zealand; or

(b) their date of acquisition (the **bright-line acquisition date**) of the land, if an instrument to transfer the land to the person is not registered on or before the bright-line date.

…

Exception: disposal of land by executor, administrator, or beneficiary

(7) This section does not apply to an amount that an executor or administrator described in section FC 1(1)(a) (Disposals to which this subpart applies), or a beneficiary described in section FC 1(1)(b), derives from disposing of residential land that was transferred to them on the death of a person (*see also*: section FC 9 (Residential land transferred to executor, administrator, or beneficiary on death of person).

Relationship with subject matter

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

A definition

(9) In this section, **date of acquisition** means the latest date on which the person acquires the estate or interest in the residential land.

36. Relevant definitions in s YA 1 are:

> **bright-line acquisition date** means the relevant bright-line acquisition date described in sections CB 6A to CB 6AE and CZ 39 (which relate to the bright-line test for residential land)
>
> **bright-line disposal date** and **bright-line date** means, for a disposal of residential land,—
>
> (a) the earliest of—
>
> (i) the date that the person enters into an agreement for the disposal:
>
> (ii) the date on which the person makes a gift of the residential land:
>
> (iii) the date on which the person's residential land is compulsorily acquired under any Act by the Crown, a local authority, or a public authority:
>
> (iv) if there is a mortgage secured on the residential land, the date on which the land is disposed of by or for the mortgagee as a result of the mortgagor's defaulting; or
>
> (b) if none of paragraph (a)(i) to (iv) apply, the date on which the estate or interest in the residential land is disposed of
>
> …
>
> **bright-line period** means, for a person and residential land, the period beginning with the relevant date described in, as applicable—
>
> …
>
> (b) section CZ 39(2) to (6) (Disposal within 5 years: bright-line test for residential land: acquisition on or after 29 March 2018), and ending with the bright-line date for the residential land

37. Accordingly, a person will have s CZ 39 income if:

- the person first acquires an estate or interest in residential land on or after 29 March 2018 (s CZ 39(1));
- s CB 6A (Disposal within 10 years: bright-line test for residential land) does not apply (s CZ 39(1));
- the exclusion for rollover relief does not apply (s CZ 39(1B));
- none of ss CB 6 to CB 12 apply (s CZ 39(8));
- the person derives an amount (s CZ 39(2));
- the amount is from disposing of residential land (s CZ 39(2));
- the disposal is within the 5-year bright-line period (s CZ 39(2) and (9)); and
- the exception for disposal of land by an executor, administrator or beneficiary does not apply (s CZ 39(7)).

Person first acquires an estate or interest in residential land on or after 29 March 2018

38. Section CZ 39 generally applies if a person first acquires an estate or interest in residential land on or after 29 March 2018. In most cases, an estate or interest in residential land is first acquired on the date a binding sale and purchase agreement is entered into (even if some conditions still need to be met).[8]

Section CB 6A does not apply

39. Section CZ 39 applies if s CB 6A (Disposal within 10 years: bright-line test for residential land) does not. The application date for s CB 6A is set out in s 48(2) of the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022:

8 QB 17/02: Income Tax – date of acquisition of land, and start date for 2 year bright-line test.

48 Section CB 6A replaced (Disposal within 10 years: Bright-line test for residential land)

(1) Replace section CB 6A with:

...

(2) Subsection (1) applies to a person's disposal of residential land, if the person acquires an estate or interest in the land on or after 27 March 2021. However, subsection (1) does not apply if the person makes an offer for the acquisition of the land, on or before 23 March 2021, that is irrevocable before 27 March 2021 and the person acquires an estate or interest in the land on or after 27 March 2021 as a result of that offer. Further, subsection (1) does not apply to—

(a) a person's disposal of a freehold estate in residential land that the person acquired as the owner of a leasehold estate with a perpetual right of renewal, if the person was granted the leasehold estate before 27 March 2021:

(b) a person's disposal of an estate or interest in residential land that the person acquired as the result of the completion of a land development or subdivision, if before 27 March 2021 the person entered into the agreement under which they acquired the estate or interest upon the completion of the land development or subdivision.

40. Section CB 6A generally applies if a person acquires an estate or interest in residential land on or after 27 March 2021. This has the effect of s CZ 39 generally applying if a person acquires an estate or interest in residential land on 29 March 2018 to 26 March 2021 (inclusive).

Exclusion for rollover relief does not apply

41. Section CZ 39(1B) says that s CZ 39 does not apply if any of the following rollover relief provisions apply and the transferor (the person who transferred the land to the person now disposing of it) first acquired an estate or interest in the land before 29 March 2018:
    - Section CB 6AB (Residential land transferred in relation to certain family trusts and other capacities);
    - Section CB 6AC (Residential land transferred in relation to certain Māori family trusts);
    - Section CB 6AE (Certain transfers of residential land included in settlement of claim under the Treaty of Waitangi); or
    - Section FB 3A (Residential land) in subpart FB (Transfers of relationship property) (see [152]).
42. Rollover relief defers the application of the bright-line test until a subsequent disposal of the land occurs that does not qualify for rollover relief.[9]

None of ss CB 6 to CB 12 apply

43. Section CZ 39(8) says that s CZ 39 applies if none of ss CB 6 to CB 12 apply. Accordingly, s CZ 39 applies only to income from the disposal of residential land that is not already otherwise taxable under these provisions.
44. Sections CB 6 to CB 12 provide that income includes amounts derived from the disposal of land in several situations. In brief, the disposals of land giving rise to income under ss CB 6 to CB 12 encompass:
    - land acquired for a purpose or with an intention of disposal (s CB 6);
    - land acquired for the purposes of a business relating to land, any such business comprising (s CB 7):
        - dealing in land;
        - developing land or dividing land into lots; or
        - erecting buildings;
    - land previously used for landfill purposes (s CB 8);
    - a land dealer's or an associated person's other land (s CB 9);
    - a land developer's or an associated person's other land (s CB 10);

9 The application of rollover provisions, including ss CB 6AB, CB 6AC and CB 6AE, is covered in detail in New legislation: Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022, Bright-line test changes, *Tax Information Bulletin* Vol 34, No 5 (June 2022): 3 at 133–145. The application of s FB 3A is discussed in New legislation: Taxation (Bright-line Test for Residential Land) Act 2015, *Tax Information Bulletin* Vol 28, No 1 (February 2016): 78 at 87.

- a builder's or an associated person's other land (s CB 11); and
- schemes for development or division into lots begun within 10 years of the date the person acquired the land (s CB 12).

45. If residential land was acquired with a purpose or with an intention of disposal, s CB 6 will apply instead of s CZ 39.[10]

Person derives an amount

46. Section CZ 39 applies to a person who derives an amount (from disposing of residential land). This raises three questions:
    - Who is the "person" subject to s CZ 39?
    - What is the "amount" subject to s CZ 39?
    - When is the amount "derived"?

Who is the "person" subject to s CZ 39?

47. The term "person" is defined in the Act only for the purposes of certain sections, which are not relevant here. Section AA 3(2) states that the Legislation Act 2019 contains definitions of terms, including the term "person", that apply to the interpretation of the Income Tax Act 2007. Section 13 of the Legislation Act 2019 defines "person" as follows:

> person includes a corporation sole, a body corporate, and an unincorporated body

48. The definition is non-exhaustive so the ordinary meaning of person is also relevant. The *Concise Oxford English Dictionary* defines a person as "a human being regarded as an individual".[11] The Income Tax Act 2007 refers to human beings as natural persons.

Company

49. Nothing in s CZ 39 limits its application to only natural persons. Being a body corporate, a company is a "person" for the purposes of s CZ 39. A company, according to s YA 1, means a body corporate or other entity that has a legal existence separate from that of its members (with some exceptions).[12]

Trust

50. An "unincorporated body" is also a "person" for the purposes of s CZ 39. An unincorporated body includes trustees of a trust.[13] A trust must possess the "three certainties" to be valid:[14]
    - certainty of intention – that is, evidence of an intention to create a trust;
    - certainty of subject matter – that is, the property that is subject to the trust relationship must be clearly identifiable; and
    - certainty of objects – that is, ascertainable beneficiaries who have the power to enforce the trust.

51. A trust is not defined in the Act. General trust law does not treat a trust as an entity. Fogarty J in *B v X [Child support]* stated:[15]

> A trust is not a juristic person with a legal personality distinct from that of the trustee and beneficiary nor is it merely descriptive of an equitable right or obligation. Instead it is a relation between trustee and beneficiary in respect of certain property. More particularly, a trust exists when the owner of a legal or equitable interest in property is bound by an obligation, recognised by and enforced in equity, to hold that interest for the benefit of others, or for some object or purpose permitted by law. That is not a definition of a trust, but a description. Precise definition is elusive, if not impossible, and attempts at such definition vary markedly.

10 See QB 16/06: Land acquired for a purpose or with an intention of disposal for details.

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

12 This statement does not consider look-through companies (subpart HB).

13 *Hieber v CIR (2002) 20 NZTC 17,774 (HC).*

14 *Royal Forest and Bird Protection Society of NZ Inc v Nelson City Council* [1984] 2 NZLR 480 (CA) and *Foreman v Hazard* [1984] 1 NZLR 586 (CA).

15 *B v X* [Child support] [2011] NZFLR 481 (HC) at 101.

52. Subpart HC, which sets out the rules on taxation of trusts, accords with the general trust law position and only provides for taxation of amounts derived by trustees as trustee income or beneficiary income. Therefore, in the context of trusts, it is the trustee who can derive income from the disposal of residential land under s CZ 39 (although this income may be taxed to the beneficiary as "beneficiary income").[16]

Nominee or bare trustee

53. If residential land has been disposed of by a person who is a nominee of another person or by a bare trustee for a beneficiary under a bare trust, the nominee or bare trustee is ignored. Section YB 21 says:

> **YB 21 Transparency of nominees**
>
> *Treatment of nominee*
>
> (1) In this Act, unless the context otherwise requires, if a person holds something or does something as a nominee for another person, the other person holds or does that thing and the nominee is ignored.
>
> *Who is a nominee?*
>
> (2) A person holds or does something as a nominee for another person if the person acts on the other person's behalf. However, a trustee is a nominee only if the trustee is a bare trustee.
>
> …

54. Section YB 21 helps to determine where the real economic control resides.[17] Section YB 21 looks through to the person who is deemed to hold or do something that the nominee holds or does (s YB 21(1)).

55. The term "nominee" is not defined in the Act. The High Court in *Equiticorp Industries Group Ltd (in stat man) v The Crown* considered the meaning of "nominee" and stated:[18]

> In *Schuh Trading Co v Commissioner of Internal Revenue* 95 F 2d 404 (1938) at p 411, a case concerning the transfer of company assets to a nominee, the Judge said: "The word nominee ordinarily indicates one designated to act for another as his [or her] representative in a rather limited sense. It is used sometimes to signify an agent or trustee. It has no connotation, however, other than that of acting for another, in representation of another, or as the grantee of another."

56. A nominee is someone who acts for or represents another and includes an agent or a trustee. They are someone who stands in the place of or is associated with the other person.[19] They can be anyone at all.[20]

57. Section YB 21 modifies this general position. Any trustee may be a nominee under general law but only a bare trustee can be a nominee for the purposes of s YB 21.

58. A nominee under an agreement for sale and purchase is not a nominee for the purposes of s YB 21. A nominee under an agreement for sale and purchase is the ultimate purchaser of the land and is not acting on behalf of another person. However, the originally named purchaser may be a nominee for the purposes of s YB 21 if they were acting on behalf of the ultimate purchaser when they entered into the agreement.

Bare trustee

59. While a trustee is ordinarily included in the meaning of nominee, a trustee is a nominee under s YB 21 only if they are a bare trustee. The term bare trustee is also not defined in the Act. In *Herdegen v FCT*, Gummow J discussed the nature of a bare trust:[21]

> Today the usually accepted meaning of "bare" trust is a trust under which the trustee or trustees hold property without any interest therein, other than that existing by reason of the office and the legal title as trustee, and without any duty or further duty to perform, except to convey it upon demand to the beneficiary or beneficiaries or as

16 See IS 18/01: Taxation of trusts – income tax.

17 IS 12/01: Income tax – timing of share transfers for the purposes of the continuity provisions at [87].

18 *Equiticorp Industries Group Ltd (in stat man) v The Crown* [1998] 2 NZLR 481 (HC) at 532.

19 *Hyndman v Anderson* [2018] NZDC 1,360.

20 *Rattrays Wholesale Ltd v Meredyth-Young & A'Court Ltd* [1997] 2 NZLR 363 (HC) at 382.

21 *Herdegen v FCT* (1988) 84 ALR 271 (FCA) at 281.

> directed by them, for example, on sale to a third party … The term is usually used in relation to trusts created by express declaration. … Also, the term "bare trust" may be used fairly to describe the position occupied by a person holding the title to property under a resulting trust flowing from the provision by the beneficiary of the purchase money for the property.

60. *Lewin on Trusts* provides a useful definition of a "bare trust" as compared with a "special trust":[22]

> The simple or bare trust is where property is vested in one person upon trust for another, and the nature of the trust, not being prescribed by the settlor, is left to the construction of law. In this case the beneficiary has … the right to be put into actual possession of the property, and … the right to call upon the trustee to execute conveyances of the legal estate as the beneficiary directs.
>
> **A bare or simple trustee … is often called a nominee. He is a mere name or "dummy" for the true owner. …**
>
> The special trust is where the machinery of a trustee is introduced for the execution of the purpose particularly pointed out, and the trustee is not, as before, a mere passive depositary of the estate, but is called upon to exert himself actively in the execution of the settlor's intention, as in the ordinary case of a trustee holding property on the express trusts of a settlement or of a will, or where a conveyance is made to trustees upon trust to sell for payment of debts. [Emphasis added]

61. A later edition of *Lewin on Trusts provides*:[23]

> A distinction has traditionally been drawn between "bare" trusts, or "simple" or "naked" trusts, and "special" trusts. **According to that distinction, a bare trustee holds property in trust for a single beneficiary absolutely and indefeasibly, and is a mere passive repository for the beneficial owner, having no duties other than a duty to transfer the property to the beneficial owner or as he directs.** By contrast a trustee holding property on special trusts has active duties to perform, for example in executing the trusts of a will or settlement, with administrative (and perhaps, also dispositive) powers accompanying his active duties. It is still possible to distinguish between an absolute trust for a single beneficiary, which might still be called a bare or simple trust, and other types of trust. [Emphasis added]

62. The meaning of "bare trustee" is stated in *Halsbury's Laws of England* as:[24]

> A bare trustee has been defined as a person who holds property in trust for the absolute benefit and at the absolute disposal of other persons who are of full age and mental capacity in respect of it, and who has himself no present beneficial interest in it and no duties to perform in respect of it except to convey or transfer it to persons entitled to hold it, and he is bound to convey or transfer the property accordingly when required to do so. It seems, however, that he is under a fairly basic duty to preserve the trust property so long as the trusteeship subsists. …

63. To summarise:

- A bare trustee has no beneficial interest in the property.[25]
- A bare trustee holds the property only to convey it to the beneficiary of the trust when required to do so.[26]
- A bare trustee must refrain from the active management of the trust property that does not fall within the duty to maintain it.[27]
- The duties of a bare trustee are passive in the sense that a bare trustee must comply with the directions of the beneficiary.[28]
- A bare trustee has no independent power, discretion or responsibility in connection with the property.[29]
- A bare trustee has a duty to take reasonable care of trust property while they hold the property.[30]

22 WJ Mowbray, *Lewin on Trusts* (16th ed, Sweet and Maxwell, London, 1964) at 6.
23 L Tucker, N Le Poidevin and J Brightwell, *Lewin on Trusts* (20th ed, Sweet and Maxwell, London, 2020) at [1-028].
24 *Halsbury's Laws of England* (5th ed, 2021, online ed) vol 98 Meaning of 'bare trustee' at [194].
25 *Halsbury's Laws of England* at [194].
26 *Halsbury's Laws of England* at [194].
27 *Bruton Holdings Pty Ltd (in liq) v FCT* (2011) 193 FCR 442.
28 *Herdegen* at 281.
29 *Paragon Development Corp v Sonka Properties Ltd* 103 OR (3d) 48 (2011).
30 *Herdegen* at 282.

- The beneficiaries of a bare trust must be of full age and mental capacity (that is, a person who is under no disability affecting their legal power to deal with the property).[31]

64. A bare trustee cannot have active duties, only passive duties. A trustee engaging in active duties would not be a bare trustee. However, taking reasonable care of and maintaining the property while awaiting the beneficiary's instructions to convey it to the beneficiary, or to transfer it to a third party, is not an active duty.

65. It is necessary to consider the nature and extent of the trustee's obligations and duties, in light of the surrounding circumstances, and any obligations imposed by the general law or by statute.[32] A bare trust also needs to meet the three certainties of a trust (intention, subject-matter and object). One of the most common scenarios in which a bare trust arises is where a purchaser (the beneficiary) provides someone else (usually called a nominee) with the money to purchase an asset.

Agent

66. An agent is a nominee for the purposes of s YB 21. Agency occurs where a person (the agent) is authorised by another person (the principal) to act on their behalf to create or affect the legal relations between the principal and third parties. The agent acts in place of the principal to bind the principal. The agent is not liable to pay the debt of the principal. An agent does not typically have a legal interest in the property they obtain as an agent.[33] An agency can be evidenced by a power of attorney.[34] In some situations, a bare trustee may act in the capacity of an agent.[35]

67. An undisclosed agent is generally not a nominee for the purposes of s YB 21. This is because an undisclosed agent contracts personally with a third party and their liability usually continues even when the third party discovers the existence of the agency. The undisclosed agent is liable to the third party in relation to debts on their own behalf, not on behalf of the principal.[36]

Evidence

68. Labels adopted by the parties are not determinative of the true nature of the transaction.[37] The Commissioner may require documentary evidence of an intention to create an agency or a bare trust. Financial records and correspondence contemporary with the time when the transaction was entered into may provide such evidence.

What is the "amount" subject to s CZ 39?

69. According to s CZ 39, a person must derive an "amount" from disposing of residential land. Section YA 1 defines "amount" by saying that it includes money's worth and refers to sections of the Act that are not relevant for the purposes of this statement.

70. "Money's worth" is not defined in the Act. Several cases have, however, considered the meaning of the term. In *Secretan v Hart (Inspector of Taxes)*, Buckley J said:[38]

> The expression "consideration, in … money's worth" is, of course, one which is very familiar to lawyers as being **a way of expressing the price or consideration given for property where the property is acquired in return for something other than money, such as services or other property**, where the price or consideration which the acquirer gives for the property has got to be turned into money before it can be expressed in terms of money. [Emphasis added]

31 *Halsbury's Laws of England* at [194].

32 *Burns v Steel* [2006] 1 NZLR 559 (HC).

33 IS 21/01 GST and Agency at [43] and [63] for features supporting the existence of an agency relationship.

34 *Laws of New Zealand Agency* (online ed) at [34].

35 QB 16/03 GST Treatment of bare trusts at [18] to [23].

36 *Laws of New Zealand Agency* (online ed) at [137].

37 *CIR v Gulf Harbour Development Ltd* (2004) 21 NZTC 18,915 (CA) at [19] (citing *Marac Life Assurance Ltd v CIR* [1986] 1 NZLR 694 (CA) at 705).

38 *Secretan v Hart* (Inspector of Taxes) [1929] 3 All ER 1,196 (ChD) at 1,199.

71. Money's worth is a way of expressing the price or consideration given for property where the property is acquired in return for something other than money, such as services or other property. Money's worth also means something that is:
    - convertible into money;[39]
    - treated by the parties as equivalent to money;[40] and
    - essentially material and capable of being valued.[41]
72. The definition is non-exhaustive, so the ordinary meaning of amount is also relevant. The *Concise Oxford English Dictionary* defines "amount" as "the total of something in number, size, value, or extent" and as "a quantity". An amount includes a monetary sum that the person has received for the disposal of residential land.

Disposal below market value

73. An amount derived for s CZ 39 purposes may be more than the amount received by the person if the land has been disposed of at below market value. For the purposes of s GC 1 (Disposals of trading stock below market value), "trading stock" includes land whose disposal would produce income under s CZ 39. The definition of "trading stock" in s YA 1 is:

> **trading stock—**
>
> …
>
> (b) in sections … GC 1 to GC 3 (which relate to the disposal of trading stock for inadequate consideration), …—
>
> …
>
> (v) includes land whose disposal would produce income under any of sections CB 6A to CB 15 and CZ 39 (which relate to income from land):
>
> …

74. Therefore, s YA 1 treats residential land subject to s CZ 39 that is disposed of for inadequate consideration as trading stock for the purposes of s GC 1. Section GC 1 states:

> **GC 1 Disposals of trading stock at below market value**
>
> When this section applies
>
> (1) This section applies when a person disposes of trading stock for—
>
> (a) no consideration:
>
> (b) an amount that is less than the market value of the trading stock at the time of disposal.
>
> *Market value consideration*
>
> (2) The person is treated as deriving an amount equal to the market value of the trading stock at the time of disposal.
>
> *Market value expenditure*
>
> (3) If the person disposes of the trading stock to another person, an amount equal to the market value of the trading stock at the time of disposal is treated as expenditure incurred by the other person in acquiring the trading stock.
>
> …

75. Section GC 1 says that when trading stock is disposed of for no consideration or for less than market value, the person is treated as deriving an amount equal to the trading stock's market value. Therefore, a person who disposes of residential land for no consideration or for less than market value, where the disposal would produce income under s CZ 39, is treated as deriving an amount equal to the market value of the residential land at the time of disposal.
76. Section GC 1 refers to the concept of "market value", which is not defined in the Act for the purposes of subparts GC

39 *Wilkins (Inspector of Taxes) v Rogerson* at 361.

40 *Hickman* at 747.

41 *Brookfield Multiplex Ltd.*

and CZ specifically or generally. Therefore, the ordinary meaning of market value will apply. The *Concise Oxford English Dictionary* defines market value as "the amount for which something can be sold in a given market".

77. Generally, the market value of something is the price that would be agreed between a willing but not anxious seller and a willing but not anxious buyer.[42] However, it is important to identify the relevant market for the land being sold.[43]

78. Also, the market value of residential land can be represented by a range and can be affected by circumstances such as the condition or particular features of the land.

79. The market value of land is determined objectively. The subjective value placed on the land by the person transferring or receiving the land is not relevant.[44] The onus to prove the market value of the land rests on the taxpayer. The market value can be different to the sale price.

80. *Edge v CIR* considered the application of ss 101 and 102 of the Land and Income Tax Act 1954, which were predecessors of s GC 1.[45] The case involved the sale of livestock together with the land, with the Commissioner determining that the livestock was valued at a different amount than the taxpayer had allocated to it in his return. Turner J said he construed s 102 as:[46]

> … applying to voluntary transactions — those in which for reasons unconnected with the market or the exigencies of commerce, **the vendor voluntarily accepts a price less than that that which he could have received by selling in the market.** This is the type of transaction which the section, in my opinion, is designed to catch. **The ordinary example of such a transaction is a sale or transfer for no consideration or for a reduced consideration to a member of one's own family,** but the transferee need be no actual relation. If the transaction partakes of the nature of a gift, **there is every reason from a fiscal point of view to add back the margin of price which the vendor has voluntarily foregone**; and this is what the statute, in my opinion was intended to do. [Emphasis added]

81. Turner J also stated that "this section does not apply to transactions which take place bona fide in the ordinary course of trade, but only to transactions containing something of the nature of a gift".[47] Turner J viewed s 102 as an anti-avoidance provision. Vendors avoiding income tax on the disposal of property, while having claimed a deduction for acquisition, were intended to be caught by s 102.

82. Therefore, s GC 1 applies to family and close relationship transactions, for the purposes of s CZ 39, where residential land has been transferred to the transferee for no consideration or below market value. Section GC 1 deems such land as having been transferred for the market value. The transferor is treated as having disposed of the residential land at market value.

Other disposals below market value

83. Section FC 1 provides a value for property that is disposed of under the following relevant transactions:
    - the transfer of property on a distribution by a trustee of a trust to a beneficiary of the trust, unless the distribution is part of an arrangement under which the beneficiary pays an amount for the property that would reasonably be expected to be paid on a disposal at arm's length (s FC 1(1)(c));[48] and
    - the transfer of property on the making of a gift (s FC 1(1)(e)).[49]

84. A trustee makes a distribution when the trustee transfers property to a person because the person is a beneficiary of the trust (s HC 14(1)). A distribution is **made** when the property vests absolutely in interest in the person (s HC 14(3)).

42 *Hatrick v CIR* [1963] NZLR 641 (CA) at 661.

43 *Edge v CIR* [1956] NZLR 799 (SC).

44 *Edge v CIR* [1958] NZLR 42 (CA) and *R v Islam* [2009] UKHL 30.

45 *Edge v CIR* [1958] NZLR 42 (CA).

46 *Edge (CA)* at 50.

47 *Edge (CA)* at 51 and 52.

48 The transfer of property on a distribution by a trustee of a trust to a beneficiary of the trust is a disposal because it meets the ordinary meaning of disposal discussed from [110], and s CZ 39 does not exempt these transactions from its ambit.

49 Gifts of residential land are included in the ambit of s CZ 39. Section YA 1 refers to gifts as part of the definition of the "bright-line date", and a gift meets the ordinary meaning of disposal discussed from [110].

85. The term "gift" is not defined in the Act. The *Concise Oxford English Dictionary* defines a gift as "a thing given willingly to someone without payment, a present". In *FCT v McPhail*, Owen J said:[50]

> … that to constitute a "gift", it must appear that the property transferred was transferred voluntarily and not as the result of a contractual obligation, and that no advantage of a material character was received by the transferor by way of return.

86. The Court of Appeal in the *Church of Jesus Christ of Latter-Day Saints Trust Board v CIR*,[51] in the context of donation tax credits, accepted this reasoning in *McPhail*.

87. Section FC 2 treats the disposals of property on a distribution by a trustee to a beneficiary, or on the making of a gift, as a disposal by the transferor and an acquisition by the transferee at the market value of the property for the transferor. The disposal is treated as occurring on the date of the transaction.

88. Therefore, s FC 2 applies to treat family and close relationship transactions for the purposes of s CZ 39 as occurring at market value where residential land has been transferred on a distribution by a trustee or on the making of a gift. However, if the distribution by the trustee is part of an arrangement under which the beneficiary pays an amount for the land that would reasonably be expected to be paid on a disposal at arm's length, this is the amount for which the land has been disposed of for the purposes of s CZ 39.

When is the amount "derived"?

89. One of the requirements of s CZ 39 is that the person must "derive" the amount in question. Section BD 3(2) (General rule) provides the general principle that an amount of income is allocated to the income year in which the amount is derived. Section BD 3 then states:

> **BD 3 Allocation of income to particular income years**
>
> …
>
> *Interpretation of derive*
>
> (3) When the time of derivation of an amount of income is being determined, regard must be had to case law, which—
>
> (a) requires some people to recognise income on an accrual basis; and
>
> (b) requires other people to recognise income on a cash basis; and
>
> (c) more generally, defines the concept of derivation.
>
> …

90. Section BD 3(3) states that case law defines the concept of derivation. It is settled law that the word "derived" means more than merely received. It connotes the source or origin rather than the fund or place from which the income was taken and means flowing, springing, emanating from or accruing.[52]

91. The general principle is that income is "derived" when it is earned and has "come home" to the taxpayer. This will be the point at which a legally enforceable debt arises or the right to be paid otherwise crystallises. Where the earning process in respect of an amount is complete, then that amount will have been derived.[53]

92. As to the timing of derivation, the Supreme Court in *Duthie v Roose concluded that the income from the disposal of land is, as a general principle, derived at settlement.*[54] This is the time when the vendor has the right to sue the purchaser for the purchase price as a debt.

93. A gift of residential land is treated as a disposal by the transferee at the market value. For the purposes of s CZ 39, the derivation of income occurs on the same date as the disposal (through the valuation mechanism in s FC 2).

50 *FCT v McPhail* (1968) 117 CLR 111 (HCA) at 116.

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

52 *CIR v Philips (NV) Gloeilampenfabrieken* [1955] NZLR 868 (SC).

53 *Arthur Murray (NSW) Pty Ltd v FCT* (1965) 114 CLR 314 (HCA).

54 *Duthie v Roose* [2017] NZSC 152.

Amount is from disposing of residential land

94. Section CZ 39 applies to a person who derives an amount "from disposing of residential land". This raises two questions:
    - What is "residential land"?
    - What is a disposal?

What is residential land?

95. For disposals of residential land covered in this statement (generally between 29 March 2018 to 26 March 2021 (inclusive)), the following definition of "residential land" applies:

> **residential land,—**
>
> (a) means—
>
> (i) land that has a dwelling on it:
>
> (ii) land for which the owner has an arrangement that relates to erecting a dwelling:
>
> (iii) bare land that may be used for erecting a dwelling under rules in the relevant operative district plan; but
>
> (b) does not include land that is—
>
> (i) used predominantly as business premises:
>
> (ii) farmland

96. Therefore, for "land" to be residential land, it must have a dwelling on it or there must be an arrangement to put a dwelling on it, or it must be bare land that may be used for erecting a dwelling (subject to exclusions).

97. "Dwelling" is defined in s YA 1 as "any place configured as a residence or abode, whether or not it is used as a place of residence or abode, including any appurtenances belonging to or enjoyed with the place". For the purposes of the definition of residential land, a dwelling also includes certain serviced apartments.

98. Farmland and business premises are excluded from residential land and are not considered in this statement.[55] This is because the property in the family and close relationship transactions considered in this statement is not farmland or business premises. "Land" is defined in s YA 1 as including any estate or interest in land. "Estate or interest in land" and "interest" are defined in s YA 1:

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

55 See QB 18/17: Income tax – bright-line test – farmland and main home exclusions – sale of lifestyle blocks and QB 19/13: Income tax – when does the business premises exclusion to the bright-line test apply?

99. Section YA 1 states that an estate or interest in land can be either legal or equitable, as well as vested, contingent, or in possession, reversion or remainder. In the Commissioner's view, this is referring to proprietary estates or interests in land.[56] An estate or interest in land also includes:
    - a right (direct or through a trustee or otherwise) to the possession of the land (such as a licence to occupy);
    - receipt of rents or other profits from the land; and
    - the proceeds of the disposal of the land.
100. For the purposes of the Act, an estate or interest in land does not include a mortgage.

Estates in land

101. An estate in land is simply an interest or a "bundle of rights" in the land. Fisher J in *Re Rural Banking & Finance Corp of NZ Ltd v Official Assignee of van Enckevort* explained this concept:[57]

> If neither the bankrupt nor the Assignee is the owner who, if anyone, does own it? For the answer it is necessary to turn to the fundamental principles upon which New Zealand land law is based. Since the Norman conquest, English land has been governed by the doctrine of tenure. By that doctrine the Crown is the overlord of all land in the kingdom. Subjects hold the land as mere tenants under grants emanating, directly or indirectly from that source. Strictly speaking subjects own not the land itself but merely an 'estate' in the land which confers certain rights to use of the land.

102. As most of the land in New Zealand is formally held by the Crown, the "tenant" does not own the land itself but an estate in the land. Estates in land are classified as freehold or less than freehold. *Hinde, McMorland and Sim Land Law in New Zealand* states:[58]

> So today an estate is freehold if it is of uncertain duration and it is less than freehold if the date of its termination is fixed or capable of being fixed.

103. An estate that is less than freehold is usually a leasehold estate.
104. Estates in land may exist as "legal estates" and "equitable estates or interests". McLelland J in *Re Transphere Pty Ltd* explained the relationship between legal and equitable estates where trust relationships are present:[59]

> An absolute owner holds only the legal estate, with all the rights and incidents that attach to that estate. Where a legal owner holds property on trust for another, he has at law all the rights of an absolute owner but the beneficiary has the right to compel him to hold and use those rights which the law gives him in accordance with the obligations which equity has imposed on him by virtue of the existence of the trust. Although this right of the beneficiary constitutes an equitable estate in the property, it is engrafted on to, not carved out of, the legal estate.

105. An absolute owner holds only the legal estate. A trustee of a trust holds the legal estate in the land, and a non-discretionary beneficiary holds the equitable estate in the land. The equitable estate is not carved out of the legal estate but is engrafted or impressed on to it.[60]
106. Another type of equitable interest in land arises under an agreement for sale and purchase of land. A purchaser will have an equitable interest in the land if they are entitled to specific performance. Specific performance requires the vendor to transfer the land to the purchaser or prevents the vendor from acting inconsistently with the agreement.[61]
107. The disposal of any estate or interest in land (legal or equitable) is, therefore, potentially within the scope of s CZ 39. Most dealings in land involve transfers of title to the legal estate, so the family and close relationship transactions considered in this statement all involve transfers of legal title. But the conclusions would be equally applicable to transfers of equitable interests in land.
108. The Commissioner does not consider that the form of co-ownership of land (that is, joint tenancy or tenancy in common) is itself an "interest in land".[62]

56 See IS 22/03: Income tax – application of the land sale rules to co-ownership changes and changes of trustees at [29] to [32].
57 *Re Rural Banking & Finance Corp of NZ Ltd v Official Assignee of van Enckevort* (1990) 1 NZ ConvC 190,589 (HC), at 593.
58 DW McMorland and others, *Hinde, McMorland and Sim Land Law in New Zealand* (online ed, LexisNexis) at [3.003].
59 *Re Transphere Pty Ltd* (1986) 5 NSWLR 309 at 311.
60 *Hinde, McMorland and Sim Land Law in New Zealand* at [4.012].
61 *Bevin v Smith [1994]* 3 NZLR 648 (CA) at 665.
62 IS 22/03: Income tax – application of the land sale rules to co-ownership changes and changes of trustees at [32] and [33].

What is a disposal?

109. Section YA 1 provides an inclusive definition of the verb "dispose" for the purposes of s CZ 39:

> **dispose,—**
>
> (a) in sections CB 6A to CB 16, CB 18, CB 19, CB 21, CB 22, CZ 39 and subpart EL (which relate to the disposal of land), for land, includes—
>
> (i) compulsory acquisition under any Act by the Crown, a local authority, or a public authority:
>
> (ii) if there is a mortgage secured on the land, a disposal by or for the mortgagee as a result of the mortgagor's defaulting under the mortgage:
>
> …

110. The Commissioner considers what is a disposal of land in IS 22/03. IS 22/03 concludes that the ordinary meaning, case law, legislative history and context indicate that "disposal" in the land sale rules (including s CZ 39):[63]

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

Therefore, in the Commissioner's view, disposal in the land sale rules does not include transfers from and to the same person in the same capacity.

111. In summary, the main reasons for the above conclusions are as follows:[64]

- The Act contains various definitions of dispose. The one relevant for the land sale rules requires consideration of the ordinary meaning of dispose. The courts have noted that dispose may have a very wide meaning, but that the context in which the word is used is key to determining the meaning it should be given.
- In the Commissioner's view, the ordinary meaning, case law, legislative history and context indicate that disposal in the land sale rules requires the characteristics set out at [110]. This is for three main reasons:
  - Consistent with dictionary definitions, at the most fundamental level a disposal involves complete alienation from the disposer of the property being disposed of. That is, the property is "got rid of" – being no longer in the control or possession of the disposer in any capacity.
  - Nothing in the history of the land sale rules suggests they were ever intended to apply to something that may technically be a disposal for property law purposes but does not involve any dealing with land (that is, ownership moving from one person to another).
  - Contextual indications in the land sale rules support this view in two particular ways:
    - The heading to subpart CB (Income from business or trade-like activities) seems consistent with a view that the land sale rules are intended to apply where there is some kind of dealing with land.
    - The existence of s CB 6A(3B) (and s CZ 39(6)) ensures the bright-line clock does not re-start when title is transferred because the trustees of a trust change. In the Commissioner's view, it would be anomalous to consider that Parliament intended that the mechanical transfer in this situation, with no change in the legal or equitable ownership of the underlying land, would be ignored for the purposes of the bright-line clock but could itself trigger the application of the bright-line test.

112. A change to the form of co-ownership (from joint tenancy to tenancy in common or vice versa), where the proportional shares or notional shares do not change, is not a disposal for the purposes of the land sale rules.[65]

113. A disposition of the legal interest in a freehold estate involves the owner "getting rid of" the legal interest. However, the owner of a legal interest in land can dispose of an equitable interest in it alone (for example, settling land on a trust). If a person holds an equitable interest in land only, the disposition of it would also constitute a disposal for the purposes of s CZ 39. Section CZ 39(2)(b) covers disposals of equitable interests alone.

63 IS 22/03 at [2].
64 IS 22/03 at [5].
65 IS 22/03 at [3].

114. Gifts are also disposals of land for the purposes of s CZ 39 and so are transfers of property on a distribution by trustees of a trust to a beneficiary of the trust. Gifts of residential land are included in the ambit of s CZ 39 by the definition of bright-line date in s YA 1. And s CZ 39 does not exempt transfers from trustees of a trust to a beneficiary of the trust.

115. Section CB 23B means the s CZ 39 bright-line test may apply to a disposal of part of the land:

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

116. Therefore, s CZ 39 does not limit the disposals of residential land to disposals of the whole of the interest in land and can include disposals of not all interests or of a part of an interest.

117. A disposition of a legal or equitable interest in land must be in writing.[66] However, this requirement does not affect the creation or operation of resulting, implied or constructive trusts, the making or operation of a will, or the disposition of any interest in land by operation of law.[67] A deed relating to a land transaction must also be in writing.[68]

Bright-line period is less than 5 years

118. For a transaction to be subject to the s CZ 39 bright-line test, the bright-line period has to be less than 5 years. The bright-line period is the period beginning with the relevant date described in s CZ 39(2) to (6) and ending with the bright-line date for residential land.

119. Section CZ 39(2) to (6) establishes the bright-line acquisition date with the general rule in s CZ 39(2). The family and close relationship transactions considered in this statement are in the context of s CZ 39(2) only. Therefore, this statement does not consider the modified bright-line acquisition dates for:[69]

- subdivisions (s CZ 39(3));
- leases with perpetual right of renewal (s CZ 39(4));
- estate or interest acquired upon completion of land development or subdivision (s CZ 39(5));
- joint tenancy converted to tenancy in common (s CZ 39(5B));
- tenancy in common converted to joint tenancy (s CZ 39(5C));
- land-owning person (s CZ 39(5D)); and
- beginning of 5-year period for transfers by registration if trustees change (s CZ 39(6)).

120. For the same reasons, this statement also does not consider the modified bright-line acquisition dates for:[70]

- residential land transferred for certain family trusts (s CZ 39(6B));
- residential land transferred to Māori authorities or similar eligible persons for certain family trusts (s CZ 39(6C)); and
- certain transfers of residential land included in settlement of claim under the Treaty of Waitangi (s CZ 39(6D)).

121. Therefore, the bright-line acquisition date relevant to this statement is:

- the date on which the instrument to transfer the land to the person was registered (s CZ 39(2)(a)); or
- the date of acquisition of the land, if an instrument to transfer the land to the person is not registered on or before the bright-line date (s CZ 39(2)(b)).

66 Section 25(1)(b) of the Property Law Act 2007.

67 Section 25(4) of the Property Law Act 2007.

68 Section 9 of the Property Law Act 2007.

69 Section CZ 39(5B), (5C), (5D) and (6) are discussed in New legislation: Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022, Bright-line test changes, *Tax Information Bulletin* Vol 34, No 5 (June 2022): 3 at 133–145. Conversions from joint tenancies to tenancies in common and vice versa and changes of trustees are covered in detail in IS 22/03.

70 Subsections (6B), (6C) and (6D) of s CZ 39 each state that it applies "despite subsections (2) to (5C)". These subsections refer to the bright-line acquisition dates in ss CB 6AB, CB 6AC and CB 6AE respectively. They are discussed in New legislation: Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022, Bright-line test changes, *Tax Information Bulletin* Vol 34, No 5 (June 2022): 3 at 133–145.

What is the date of registration?

122. The registration date is the date when the instrument of the transfer of the residential land to the person is registered under the Land Transfer Act 2017 (or under a foreign law of a similar nature if the land is outside New Zealand).

123. Section 51(1) of the Land Transfer Act 2017 explains that, on the land's registration, a person as the owner of an estate or interest in land obtains a title to the estate or interest that cannot be set aside.

What is the date of acquisition?

124. If there is no date of registration, then the date of acquisition is relevant. The date of acquisition is defined in s CZ 39(9) to mean "the latest date on which the person acquires the estate or interest in land".

125. In the context of s CZ 39(9), the "latest date" the person acquires the estate or interest in land depends on the type of interest acquired. If it is a legal interest, the latest date is the date of registration and para (a) of s CZ 39(2) will apply.

126. It follows then that the date of acquisition in para (b) of s CZ 39(2) applies to the acquisition of equitable interests. It is considered the reference to the "latest date" is consistent with the date of registration being the latest date of acquisition for legal interests.

127. However, unlike with legal interests, there are not various points in time that an equitable interest could be said to be acquired. Therefore, the date of acquisition is the date the equitable interest arises. For off-the-plans sales, the acquisition date is when the person enters into a binding sale and purchase agreement with the vendor to buy off-the-plans.[71]

What is the bright-line date?

128. The definition of the "bright-line date" in s YA 1 states:[72]

> **bright-line disposal date** and **bright-line date** means, for a disposal of residential land,—
>
> (a) the earliest of—
>
> (i) the date that the person enters into an agreement for the disposal:
>
> (ii) the date on which the person makes a gift of the residential land:
>
> (iii) the date on which the person's residential land is compulsorily acquired under any Act by the Crown, a local authority, or a public authority:
>
> (iv) if there is a mortgage secured on the residential land, the date on which the land is disposed of by or for the mortgagee as a result of the mortgagor's defaulting; or
>
> (b) if none of paragraph (a)(i) to (iv) apply, the date on which the estate or interest in the residential land is disposed of

129. Relevant to this statement, the "bright-line date" is either:

- the earlier of the date when the person enters into an agreement for the disposal of residential land or makes a gift of residential land; or
- if there is no such agreement for the disposal or making of a gift, the date on which the person disposes of an estate or interest in the residential land.

130. For standard sales of residential land, the end date for the bright-line period is the date the person enters into an agreement to sell the land.

131. For gifts of residential land, the end date for the bright-line period is the date the person makes the gift of the residential land. This will be the date when the donor has done everything necessary to transfer the land and render the gift binding.[73]

132. For all other disposals, the end date for the bright-line period is the date the land was disposed of. The date that land is disposed of is not defined in the Act, so ordinary rules apply. It is considered that the date that land is disposed of under ordinary rules will be when the vendor has divested themselves of all of their interests in the residential land.[74]

71 QB 17/02 at [31]-[32], [51]-[52], [64]-[65] and Example 4.

72 "Bright-line disposal date" is referred to in s CZ 39(5B), (5C), (6B), (6C) and (6D). "Bright-line date" is referred to in s CZ 39(2) to (5).

73 *Milroy v Lord* (1862) 4 De GF & J 264 at 274, 45 ER 1,185 at 1,189 (Ch).

74 *Henty House Proprietary Ltd (in vol liq) v FCT* (1953) 88 CLR 141 (HCA).

Exception for an executor, administrator or beneficiary

133. The exception from the s CZ 39 bright-line test for an amount derived by an executor, administrator or beneficiary from disposing of land that was transferred to them on the death of a person is in s CZ 39(7):

> *Exception: disposal of land by executor, administrator, or beneficiary*
>
> (7) This section does not apply to an amount that an executor or administrator described in section FC 1(1)(a) (Disposals to which this subpart applies), or a beneficiary described in section FC 1(1)(b), derives from disposing of residential land that was transferred to them on the death of a person (*see also*: section FC 9 (Residential land transferred to executor, administrator, or beneficiary on death of person).

134. An executor or administrator referred to in s CZ 39(7) is described in s FC 1(1)(a) as an executor or administrator to whom the estate has been transferred on the death of the person. A beneficiary referred to in s CZ 39(7) is described in s FC 1(1)(b) as "a beneficiary who is beneficially entitled to receive the property under the will or the rules governing intestacy".

135. These transfers are also excluded from the s CZ 39 bright-line test but under s FC 9(2):

> **FC 9 Residential land transferred to executor, administrator, or beneficiary on death of person**
>
> *What this section applies to*
>
> (1) This section applies in the circumstances described in section FC 1(1)(a) or (b) when residential land is transferred on a person's death and section FC 5 does not apply.
>
> *Residential land*
>
> (2) Section CB 6A and CZ 39 (which relate to the bright-line test for residential land) do not apply to the transfer of the residential land, including any intervening transfer to an executor or administrator (*see also*: sections CB 6A(2B) and CZ 39(7)).
>
> …

136. Therefore, the following transfers and disposals are excluded from the s CZ 39 bright-line test:[75]

- residential land transferred on the death of a person to an executor or administrator (s FC 9(2));
- residential land transferred on the death of a person to an executor or administrator that was disposed of by the executor or administrator (s CZ 39(7));
- residential land transferred from an executor or administrator to a beneficiary under a will or under rules of intestacy (s FC 9(2)); and
- residential land transferred from an executor or administrator to a beneficiary under a will or rules of intestacy that was disposed of by the beneficiary (s CZ 39(7)).

Analysis | Tātari – Family and close relationship transactions

137. Having discussed the requirements of s CZ 39, this statement now discusses whether s CZ 39 applies to the following family and close relationship transactions when the ownership of residential land (that is not a main home) changes from:

- parents to their child to assist the child with buying their first home;
- one partner to themselves and their new partner; and
- all the beneficiaries who inherited the land under a will to some of the beneficiaries.

Parents and child

138. The Commissioner has been informed of instances when parents try to assist their child to buy a house because the child:

- is not able to do it without such assistance; or
- needs extra time to access their KiwiSaver funds.

75 Section FC 5 applies to transfers under ss CB 9 to CB 11 and CB 14, which relate to the disposal of land.

139. The child sometimes provides a part of the initial deposit for the purchase by the parents or the parents fully cover the deposit. The child lives in or rents the property and may pay or reimburse the parents for all or some of the mortgage and other expenses associated with the property.

140. The property is eventually transferred from the parents (in their personal capacity or as trustees of a trust, nominees or shareholders of a company) to the child. The value of the property could have increased during the time the parents or entity owned it.

141. The Commissioner concludes that the s CZ 39 bright-line test applies to the following family transactions because a person has derived an amount from disposing of residential land (assuming all other requirements of s CZ 39 are met):

- a disposal from parents, as individuals, to their child (see Example 1 after [147]);
- a disposal from a company (which is not a look-through company), where the parents are shareholders, to their child (see Example 2 after [147]); and
- a disposal from parents, who are the trustees of a trust, to their child who is a beneficiary of the trust (see Example 3 after [147]).

142. If the amount derived from the disposal is below the market value of the residential land, it is treated as being the market value (see Examples 1 and 3 after [147]).

143. A transfer from parents, who are nominees for their child under s YB 21, to their child is not a disposal for the purposes of s CZ 39. For example, a transfer from parents who are bare trustees for their child to their child who is a beneficiary of the bare trust is not a disposal. The criteria that help determine whether parents are nominees under s YB 21 for their child are covered in [53] to [68]. See Examples 4 and 5 after [147].

144. Situations can arise when parents take out a loan to purchase residential land for their child and assume personal obligations for the repayment of the loan. The Commissioner considers that in these situations this is an active duty so the parents are not acting as bare trustees.

145. Likewise, the Commissioner considers that parents who borrow funds to purchase a property for their child are not their child's agents. They do not create or affect the child's relationship with third parties (for example, the lending institution). They borrow funds and purchase the property in their own right, not on behalf of their child.

146. Deductions are allowed under part D for the cost of the residential land, such as acquisition costs and capital improvements (s DB 23 (Cost of revenue account property) as limited by s EL 20 (Allocation of deductions related to bright-line disposals of residential land)). The deduction is taken in the income year in which the land is disposed of (s EA 2 (Other revenue account property)).

147. Any earlier deductions carried forward under the residential rental ring-fencing rules in subpart EL (Allocation of deductions for excess residential land expenditure) may be allowed to be allocated to the income year under s EL 5 (When residential portfolios sold) or s EL 7 (When property A sold). Any allowable deductions reduce the amount of income taxable under the s CZ 39 bright-line test.

Example | Tauira 1 – Sale from parents, as individuals, to their child for below market value

Blake has savings but not enough to buy a house with an asking price of $900,000. Blake's parents decide to buy the house on behalf of themselves. They obtain a mortgage for $900,000 to purchase the property under their names. Blake moves in and lives in the property and makes payments in the nature of rent to his parents to partially reimburse them for their mortgage interest expenses and other expenses relating to the property.

Four years later, Blake's parents' financial circumstances change so they decide to sell the property to him for the sum of $900,000, which is the same as what they paid when they acquired it. The bank lends Blake $720,000 (80% of $900,000). Blake also pays $180,000 from his savings to his parents directly.

The market value of the property at the time of the sale from Blake's parents to Blake has, however, risen to $1.2m.

For s CZ 39 to apply, Blake's parents must derive an amount from disposing of residential land (assuming all other requirements are met). In accordance with s GC 1, the "amount", for the purposes of s CZ 39, is $1.2m, despite the parents agreeing to sell the property below its market value ($900,000).

The amount was derived by Blake's parents from disposing of residential land. It was residential land because it was an estate in fee simple with a dwelling on it. Blake's parents have disposed of their interest in land as there has been a sale of a legal interest in land. Therefore, s CZ 39 applies to Blake's parents. While Blake's parents derived an amount of $1.2m, they will be allowed a deduction under part D for the cost of the property (including the $900,000 they paid for the property).

If Blake's parents had acquired and disposed of a lesser share in the property to Blake, s CZ 39 would have applied to the lesser share.

Example | Tauira 2 – Sale from a company (which is not a look-through company), where the parents are shareholders, to their child

Charlie wants to buy a house in Invercargill that costs $500,000. They had to be a cash buyer, but because it would take them too long to sort out their KiwiSaver funds, they could miss out on the house. Their parents, who are the only shareholders in Parents Ltd (which is not a look-through company), stepped in and purchased the house for Charlie for $500,000 under the name of Parents Ltd. Charlie is not a shareholder in Parents Ltd. Six months later, Parents Ltd sells the house to Charlie for $500,000, which was still its market value.

For s CZ 39 to apply, Parents Ltd must derive an amount and the amount must arise from disposing of residential land (assuming all other requirements are met). Parents Ltd has derived an amount of $500,000 as this is the monetary sum that it received and is the market value of the house.

The amount was derived by Parents Ltd from disposing of residential land. It was residential land because it was an estate in fee simple with a dwelling on it. Parents Ltd has disposed of its legal interest in land as there has been a sale of the land. Therefore, s CZ 39 applies to Parents Ltd. While Parents Ltd derived an amount of $500,000, they will be allowed a deduction under part D for the cost of the property (including the $500,000 it paid for the property).

The facts of Example 2 indicate that Parents Ltd may have acquired the house with a purpose or an intention of disposing of it to Charlie. If that was so, s CB 6 would apply instead of s CZ 39.

Example | Tauira 3 – Transfer from parents who are the trustees of a trust to their child who is a beneficiary of a trust

For the last 18 months, trustees of the Lachlan Family Trust (a complying trust) have owned a house in Kerikeri, which is usually vacant. Don and Grant are the trustees of the trust, and Hunter is one of the discretionary beneficiaries of the trust. Don and Grant are Hunter's parents. Don and Grant, in their capacity as trustees, have resolved to transfer the house to Hunter for no consideration. The market value of the property is $700,000.

For s CZ 39 to apply, the trustees must derive an amount and the amount must arise from disposing of residential land (assuming all other requirements are met). The trustees are treated as having disposed of the property to Hunter at market value (ss FC 1(1)(c) and FC 2). Therefore, they have derived an amount of $700,000 as this is the market value of the property.

The amount was derived by the trustees from disposing of residential land. It was residential land because it was an estate in fee simple with a dwelling on it. The trustees have disposed of their legal interest in land as it has been transferred to Hunter. Therefore, s CZ 39 applies to the trustees. While the trustees derived an amount of $700,000, they will be allowed a deduction under part D for the cost of the property (including the amount they paid for the property).

Note that this transaction is not a gift for the purposes of s FC 1(1)(e), as s FC 1(1)(c) is the section that deals with transfers of property from trustees of a trust to a beneficiary of the trust.

Example | Tauira 4 – Transfer from parents who are bare trustees for their child to their child

Jacob is working overseas and plans to return to New Zealand at the end of the year. He has saved enough money to afford to buy a modestly priced house mortgage-free. This money is a combination of Jacob's savings and money he inherited from his grandmother. Jacob's parents, Teresa and Manaia, believe property prices may increase by the time Jacob returns, which may make it harder for Jacob to find an affordable house. Teresa and Manaia live in Dunedin, which is where Jacob wants to be when he returns. As Jacob is very busy with his work, he would like his parents to purchase a house for him and handle all the conveyancing.

Jacob asks his parents to act on his behalf as bare trustees. They agree that Jacob will choose the property and the parents will use his money to buy it. The parents will register the property under their names until Jacob returns, when they will transfer it to him. This understanding can be clearly ascertained from contemporaneous emails exchanged between them.

Jacob transfers his money to his parents, and the parents purchase the property he chose for $350,000. There is no mortgage against the house. The property is registered in the parents' names and sits empty awaiting Jacob's return. The parents arrange for basic maintenance like lawn mowing. When Jacob returns in 10 months, the property is transferred from his parents to him.

Jacob's parents acted in their capacity as bare trustees for Jacob so they are nominees for the purposes of s YB 21. Section YB 21 means Jacob is the "person" who holds the property that is registered under his parents' names. As Jacob is deemed to hold the interest in the property instead of his parents, he is deemed to have held the legal title in the property from when his parents acquired it.

Section CZ 39 does not apply to Jacob because a transfer from and to oneself in the same capacity is not a disposal for the purposes of the land sale rules. Therefore, Jacob is not subject to the s CZ 39 bright-line test.

Example | Tauira 5 – Sale from parents to their child with no bare trust relationship

Lucia wants to buy a house in a provincial town in New Zealand with an asking price of $900,000. Lucia is not in a position to secure a mortgage and does not have a deposit. However, she is starting a well-paying job in the next couple of months and thinks she should be in a position to own a house within the next few years. Lucia's parents, Emilio and Anna, agree to help her out and buy a house on behalf of themselves.

Emilio and Anna obtain a mortgage for $720,000 to buy a house. They are the principal borrowers in relation to this sum, which means they assume personal obligations to repay the mortgage. They pay a deposit of $180,000. Lucia is living with her parents to save money and the house is rented out. Her parents take care of the mortgage repayments and other property expenses.

In a few years, Lucia is ready to purchase a house. She has saved enough for a deposit and obtains a mortgage. Emilio and Anna decide to sell the house they acquired to her for $900,000, which is still the market value of the house.

There is no bare trust for Lucia, and Emilio and Anna are not bare trustees. This is because bare trustees can have only passive duties. Assuming personal obligations for the mortgage in this situation is not a passive duty. Therefore, Emilio and Anna are not nominees for the purposes of s YB 21.

For s CZ 39 to apply, Emilio and Anna must derive an amount and the amount must arise from disposing of residential land (assuming all other requirements are met). Emilio and Anna derive an amount of $900,000 from disposing of residential land. The house is residential land because it is an estate in fee simple with a dwelling on it. They have disposed of their legal interest in land as they sold it to Lucia. Therefore, s CZ 39 applies to Emilio and Anna. While they derived an amount of $900,000, they will be allowed a deduction under part D for the cost of the property (including the $900,000 they paid for the property).

If the market value of the house had increased from $900,000, Emilio and Anna would have derived the increased amount instead (s GC 1).

New partner

148. The Commissioner has been asked whether the bright-line test applies when the ownership of residential land changes from one partner (A) to themselves and their new partner as co-owners (A and B).

149. In the Commissioner's view, "disposal" in the land sale rules (including s CZ 39) does not include transfers from and to oneself in the same capacity. Therefore, partner A disposes of only half of the land to partner B, and s CZ 39 applies to that extent (assuming all other requirements are met) (see Example 6 after [152]).

150. Any subsequent disposals by partners A and B to another person will be subject to s CZ 39 (assuming all other requirements are met) (see Example 7 after [152]).

151. Deductions will be allowed under part D for the relevant share of the cost of the residential land (see [146] and [147]).

152. If partner A had subsequently transferred their share of the land to partner B under a settlement of relationship property, s CZ 39 would not apply (s CZ 39(1B) and s FB 3A). A "settlement of relationship property" means a transaction under a relationship agreement that creates a disposal and acquisition of property between the parties (s FB 1B). A "relationship agreement" is an agreement for the purpose of Part 6 of the Property (Relationships) Act 1976 (that is, a contracting out or prenuptial agreement), or a court order under s 25 of the same Act (s YA 1).

Example | Tauira 6 – Transfer from one partner to both partners as co-owners

Josh and Zhuo are in a relationship and decide to buy a house in New Plymouth where they are going to live together. Josh sells the house he owns and has lived in in New Plymouth to purchase a new house for $640,000. Josh and Zhuo own the new house as equal co-owners. Zhuo indirectly contributes to the purchase of the new house by transferring the rental property in Auckland that she has owned for 3 years (with a market value of $640,000) to herself and Josh as co-owners.

For s CZ 39 to apply to the transfer of the rental property, Zhuo must derive an amount and the amount must arise from disposing of residential land (assuming all other requirements are met). Despite Josh not providing Zhuo with any monetary sum in relation to the transfer, the amount is represented by the money's worth of half of the share that Zhuo has acquired in the new house she bought with Josh ($320,000).

The amount is from disposing of Zhuo's rental property because Zhuo and Josh agreed to include Zhuo as a co-owner of the new house if she added Josh as a co-owner of Zhuo's rental property.

As Zhuo has disposed of half of her interest in her rental property to Josh, s CZ 39 applies to Zhuo for the amount of $320,000. While Zhuo has derived an amount of $320,000, she will be allowed a deduction under part D for half of the cost of the property (including half of the amount she paid for the property).

The same outcome would apply if Josh had provided no consideration for the transfer of the property from Zhuo to Zhuo and Josh. This is because s GC 1 would apply and Zhuo would be taxable on the market value of the transferred interest (that is, $320,000).

Example | Tauira 7 – Sale from partners, as co-owners, to a third party

Due to changing circumstances, Zhuo and Josh as co-owners of the rental property that was initially owned by Zhuo (referred to in Example 6), sell the property 1 year later to Ahmed for $700,000.

The sale of the rental property is subject to s CZ 39 because Zhuo and Josh have derived an amount from disposing of residential land (assuming all other requirements are met). They have both owned their half shares in the rental property for less than 5 years (that is, Zhuo for 4 years and Josh for 1 year). They will each be allowed a deduction under part D for the cost of their share in the rental property.

If Zhuo had held her half share in the rental property for more than 5 years, then s CB 23B would have applied so that only Josh would have derived $350,000. However, Josh would have been allowed a deduction under part D for his share of the cost of the property (including the $320,000 money's worth he provided for his share).

Inherited property

153. The Commissioner has been asked whether the s CZ 39 bright-line test applies when the ownership of residential land changes from all the beneficiaries who inherited a property under a will or rules of intestacy to some of the beneficiaries.
154. The transfer from one beneficiary of their share to other beneficiaries is exempted from the s CZ 39 bright-line test by s CZ 39(7). This is because that share was acquired under a will or rules of intestacy (see Example 8 after [156]).
155. However, subsequent disposals by the remaining beneficiaries of the property to a third party are exempted only to the extent of their original shares in the land acquired under a will or rules of intestacy. Section CB 23B means that the s CZ 39 bright-line test can apply to a part of the land (see Example 9 after [156]).
156. Deductions will be allowed under part D for the cost of the residential land (see [146145] and [147]).

Example | Tauira 8 – Sale of share of inherited land from one beneficiary to the other beneficiaries

Siblings Ella, Riley and George are the beneficiaries under the will of Ms McDonald who recently passed away. They are set to inherit her house in equal shares (one-third each). Following Ms McDonald's death, all of her assets, including the house, were passed on to the executor of her estate, Mr Pauls, for administration and distribution to the beneficiaries.

The house was transferred to the siblings and they decide to rent it out. Riley decides she would rather have her investments elsewhere, so she asks Ella and George to buy her out. Ella and George agree and acquire Riley's one-third share for one-third of the market value of the house.

These three disposals of residential land are excluded from s CZ 39. The transaction:

- from the deceased, Ms McDonald, to Mr Pauls is excluded by s FC 9(2) (as referred to in s CZ 39(7));
- from Mr Pauls to Ella, Riley and George is excluded by s FC 9(2); and
- from Riley, in relation to the sale of her one-third share, to Ella and George is excluded by s CZ 39(7).

Example | Tauira 9 – Sale of inherited land to a third party

In 12 months' time, Ella and George sell the house they inherited (referred to in Example 8) that they now co-own equally to a third party, Mere.

The sale of residential land by Ella and George to Mere is excluded from s CZ 39 by s CZ 39(7) only to the extent of the two-third share that they inherited under the will, represented by two-thirds of the sale price. The one-third share they acquired from Riley was not acquired by Ella and George under a will.

Section CZ 39 applies to one-third of the sale price. Section CZ 39 can apply to a part of the disposed land. Ella and George have derived an amount from disposing of residential land (assuming all other requirements are met) to Mere. They will each be allowed a deduction under part D for the cost of the share they acquired from Riley.

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IS 23/03: GST – Section 58: Specified agents of incapacitated persons, and mortgagees in possession

Issued: 27 April 2023

This Interpretation Statement considers the application of section 58 of the Goods and Services Tax Act 1985. Section 58 covers the GST implications where there is a specified agent of an incapacitated person or a mortgagee is in possession of land or property of a mortgagor.

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

Summary

1. Section 58 covers two broad areas:
   - Specified agents of incapacitated persons; and
   - Mortgagees in possession of land or other property of a mortgagor.
2. In each area, section 58 applies to treat the specified agent as, or deem the mortgagee in possession to be, the registered person in respect of the taxable activity of the incapacitated person, or mortgagor, respectively.
3. The Commissioner issued a policy statement on this subject in 1995.[1] This Interpretation Statement replaces that earlier statement and extends the analysis beyond what it covered.
4. This Interpretation Statement reiterates the earlier view that where a registered person dies or is in liquidation, receivership, or voluntary administration, then their personal representative, liquidator, receiver, or administrator will be a specified agent of an incapacitated person and liable to fulfil the GST obligations related to the taxable activity in question.
5. However, where a person is adjudicated bankrupt (and so becomes an "incapacitated person" as defined), the Official Assignee will **generally** not be a specified agent of that bankrupt registered person and will therefore not be responsible for the GST obligations related to that bankrupt's taxable activity. The exception is where the Official Assignee has used its power under Schedule 1(i) of the Insolvency Act 2006 ("the IA 2006") to carry on the bankrupt's business (taxable activity).
6. For a mortgagee in possession of land or property of a registered person mortgagor, the Commissioner **may** deem the mortgagee to be a registered person where and to the extent that the mortgagee carries on any taxable activity of the mortgagor. Unlike specified agents, who are automatically treated as registered persons in respect of an incapacitated person's taxable activity, the Commissioner has a discretion to do the same in respect of a mortgagee in possession.

Introduction

7. This Interpretation Statement replaces and updates the policy statement entitled "GST – specified agent for incapacitated persons" published in 1995.[2] The 1995 statement and this Interpretation Statement relate to section 58 of the Act.
8. Section 58 covers more than just specified agents of incapacitated persons, extending to mortgagees in possession of land and other property of a mortgagor as well. While the title of the 1995 statement suggests it covered only the issue of specified agents of incapacitated persons, in its discussion it also addressed the application of section 58 to mortgagees in possession. This Interpretation Statement likewise covers both aspects of section 58.

An overview of how section 58 works

9. Section 58(1) sets out three definitions that are critical to its application to the extent that it relates to a specified agent of an incapacitated person. These define "agency period", "incapacitated person", and "specified agent":

   agency period means the period beginning on the date on which a person becomes entitled to act as a specified agent carrying on a taxable activity in relation to an incapacitated person and ending on the earlier of—

   (a) the date on which some person other than the incapacitated person or the specified agent is registered in respect of the taxable activity; or

1 "GST – specified agent of an incapacitated person", *Tax Information Bulletin* Vol 7, No 6 (December 1995): 13.

2 *Tax Information Bulletin* Vol 7, No 6 (December 1995): 13.

(b) the date on which there is no longer a person acting as a specified agent in relation to the incapacitated person

incapacitated person means a registered person who dies, or goes into liquidation, receivership, or voluntary administration, or becomes bankrupt or incapacitated

specified agent means a person carrying on any taxable activity in a capacity as personal representative, liquidator, receiver, or administrator of an incapacitated person, or otherwise as agent for or on behalf of or in the stead of an incapacitated person.

10. As the above definition indicates, "agency period" means the period when a person acts as the specified agent carrying on a taxable activity of an incapacitated person. It begins with the date when the person is entitled to act as a specified agent and continues until either someone other than the specified agent or the incapacitated person is registered as carrying on the taxable activity **or** there is no longer a specified agent in relation to the incapacitated person.
11. "Incapacitated person" means a registered person, in respect of a taxable activity, who dies, goes into liquidation, receivership, or voluntary administration, or becomes bankrupt or "incapacitated". The terms "dies", "liquidation", "receivership", "voluntary administration", and "bankrupt" are very specific, but "incapacitated" is a broader and more general term.
12. "Specified agent" is the term linked with "incapacitated person". The first half of its definition – referring to the terms "personal representative", "liquidator", "receiver", and "administrator" – links to some of the specific circumstances in the definition of "incapacitated person" ("dies", "liquidation", "receivership", "voluntary administration"). However, the second half – "or otherwise as agent for or on behalf of or in the stead of an incapacitated person" – applies more broadly to the remaining circumstances in the definition of "incapacitated person" ("bankrupt", "incapacitated").
13. Section 58(1A) provides that a person who becomes a "specified agent" is treated as being a registered person carrying on the taxable activity of the incapacitated person. Additionally, the incapacitated person is treated as not carrying on the taxable activity. This treatment is different to the way an agent is usually treated (under section 60(1)) and for this reason section 58(1A) states it applies despite "sections 5(2) and 60". The treatment is different because of the context involving an agent of someone who is an "incapacitated person". That is, because an incapacitated person does not have the competence to act on their own behalf, more is expected of their (specified) agent. Section 58(1B) is a similar rule to section 58(1A) in the context of a specified agent carrying on only part of the incapacitated person's taxable activity. In either case the specified agent is personally liable for any GST liabilities arising during the agency period.
14. Section 58(1D) provides that the specified agent is not personally liable for any GST liabilities that the incapacitated person incurred on or before the date the agency period started. However, if an incapacitated person had not claimed input tax before the agency period started, section 58(1C) allows the specified agent to claim that amount.[3] While a specified agent is not personally liable for GST obligations before the agency period, they may, when they have authority to do so, take responsibility as agents for filing GST returns and paying outstanding GST.
15. Section 58(2) has a specific rule for a mortgagee in possession of land or other property where the mortgagee carries on the taxable activity of the mortgagor. The Commissioner **may** deem the mortgagee to be the registered person from the time they took possession until the time they cease to be in possession. Unlike "specified agents", who are automatically treated as registered persons under section 58(1A), a mortgagee in possession **may** be treated ("deemed") as being a registered person.
16. Section 58(3) requires a specified agent, or a mortgagee in possession carrying on a taxable activity of a mortgagor, to notify the Commissioner within 21 days of such occurring, and to provide details of the facts leading to this.

Applying section 58 in the case of death, liquidation, receivership, and voluntary administration

17. Section 58 applies clearly in the case of death, liquidation, receivership, and voluntary administration. A person who dies or a company in liquidation, receivership, or voluntary administration will be an "incapacitated person" as defined. A personal representative of a deceased person, a liquidator of a company, a receiver of a company, or an administrator of a company satisfies the definition of "specified agent" (if they are carrying on the taxable activity of the incapacitated person). It is not uncommon to have a company that is both in receivership and liquidation, and hence there may be more than one specified agent of the company (that is, both the receiver and the liquidator).

3 Section 58(1C) is subject to section 46(7), which allows the Commissioner to apply any such input tax deduction towards outstanding GST obligations of the incapacitated person or to an amount payable by the incapacitated person under another Inland Revenue Act.

18. In the period between the death of a person and the appointment of an executor or administrator as the deceased's personal representative, another person may be acting as a "specified agent" in the interim if they act "as agent for or on behalf of or in the stead of" the deceased (from the definition of "specified agent"). This will be the case if a person continues to carry on the deceased's taxable activity between the time of death and the appointment of a personal representative (by grant of probate or letters of administration).

Applying section 58 in the case of bankruptcy

19. How section 58 applies in the case of a bankruptcy is less clear. While it is clear that a "bankrupt" is an "incapacitated person", it does not follow that the Official Assignee must be a "specified agent". Unlike personal representatives, liquidators, receivers, and administrators, the Official Assignee is not listed in the definition of "specified agent". But it is acknowledged that the Official Assignee is responsible for administering all bankruptcies.
20. However, just because the Official Assignee is responsible for administering all bankruptcies, it does not follow that the Official Assignee must be a specified agent. Not every "incapacitated person" must have a "specified agent", and section 58(1A) does not have to apply every time there is an incapacitated person. Instead, the person who may be a "specified agent" must satisfy the requirements of the definition including that they must be:
    - carrying on a taxable activity; and
    - carrying on the taxable activity in a specific capacity (as personal representative, liquidator, receiver, or administrator) **or** otherwise as agent for or on behalf of or in the stead of an incapacitated person.
21. Therefore, as well as needing confirmation that a potential "specified agent" is carrying on a taxable activity, it must be confirmed that they are doing that either in a specific capacity (as personal representative, liquidator, receiver, or administrator) **or** they are doing so as agent for or on behalf of or in the stead of the incapacitated person. For example, carrying on the taxable activity for a person's own benefit would not necessarily satisfy the definition.
22. The Official Assignee will not be a "specified agent" for an incapacitated person bankrupt when the Official Assignee:
    - is not aware of and has not consented to the incapacitated person carrying on a taxable activity; or
    - has given consent for the incapacitated person to carry on a taxable activity (under section 149 of the IA 2006) but on condition that the incapacitated person meets all the GST requirements of that taxable activity (including filing GST returns and paying GST).
23. However, the Official Assignee will be a "specified agent" of an incapacitated person bankrupt when the Official Assignee carries on the bankrupt's taxable activity because that is necessary or advantageous in order to dispose of it (see Schedule 1(i) of the IA 2006). In such a case, the Official Assignee is carrying on the taxable activity "as agent for or on behalf of or in the stead of" an incapacitated person (fulfilling the definition of "specified agent").

Applying section 58 in the case of other incapacity

24. Section 58 also applies when a person becomes "incapacitated" (see above at paragraph 11). The *Oxford English Dictionary* (3rd ed, March 2016, most recently modified version published online December 2022)4 defines "incapacitate" as follows (observing that "incapacitated" is the adjectival form of "incapacitate"):

    Incapacitate, v

    1. *transitive*. To deprive of capacity; to render incapable; to disqualify, unfit.

    2. To deprive of legal capacity; to disqualify in law.

25. The word has two possible meanings – a general meaning which is often interpreted as meaning physical, mental, or intellectual impairment, or a specifically legal meaning referring to legal incapacity.
26. So a person will be "incapacitated" in terms of the definition of "incapacitated person" when they lose physical, mental, or intellectual capacity such that they are unable to carry on their taxable activity or where they are deprived of legal capacity to carry on their taxable activity.

4 Accessed 28 February 2023.

Applying section 58 in the case of a mortgagee in possession

27. Section 58(2) relates to the case of a mortgagee in possession of land or property of a registered person mortgagor. Where and to the extent that the mortgagee carries on any taxable activity of the mortgagor, the Commissioner may deem the mortgagee to be a registered person. Any such deemed status will apply from the date when the mortgagee took possession of the land or other property until the time the mortgagee ceases to be in possession of the land or other property.
28. The Commissioner's view is that if he deems a mortgagee in possession to be the registered person, then the mortgagor (no longer in possession) is not the registered person for the equivalent period.

Section 58(3) notification requirements

29. Section 58(3) requires any person who becomes a specified agent, or who is a mortgagee in possession carrying on a taxable activity of a mortgagor, to notify the Commissioner within 21 days of this event. The person must also notify the Commissioner of the date (as relevant) of the:
    - death;
    - liquidation;
    - receivership;
    - voluntary administration;
    - bankruptcy; or
    - mortgagee's taking possession of the land or other property.
30. Where a person becomes otherwise "incapacitated" (within the definition of "specified agent"), the specified agent must notify the Commissioner of the nature of the incapacity and the date on which it began.

Other relevant provisions

31. Sections 15E(3) and 15E(4) provide a special rule for the early end of a taxable period when a natural person dies or is made bankrupt (section 15E(3)(a)) or a company goes into liquidation or receivership (section 15E(3)(b)). Where such an event occurs the date of the event is treated as the end of the person's taxable period.
32. A specified agent who sells a taxable activity of an incapacitated person may be able to zero-rate the supply as the supply of a going concern (section 11(1)(m)) or, if the supply wholly or partly consists of land, as a supply of land (section 11(1)(mb)). To do so, they would need to meet the specific requirements of whichever of those provisions is relevant each of those provisions.

Examples

33. The following examples illustrate the application of section 58 discussed above.

Example 1: Notification requirement

Mina owns and runs a sports memorabilia store as a sole trader, for which she is GST registered. In April 2022 Mina dies after a short illness. Her only child, Carlos, is her personal representative and decides to keep running the store for the time being, originally as a specified agent "in the stead of" Mina, and later as Mina's personal representative after being granted probate of her will.

Carlos is the specified agent of an incapacitated person (Mina) and notifies the Commissioner of this within 21 days of becoming a specified agent, as section 58(3) requires. Carlos is treated as a registered person in respect of the sports memorabilia taxable activity. From that time onwards he is responsible for filing GST returns and paying GST.

Example 2: Before the specified agency period

Rio and Vida Limited operated as a security company. On 21 May 2022 the company went into liquidation and Edwin was appointed as liquidator. Edwin discovers that the company's GST systems have been poorly managed, and some GST input tax has not been claimed in the previous taxable periods when it should have been.

Edwin is entitled, under section 58(1C), to deduct the input tax that relates to supplies made before the agency period began.

As a result of going into liquidation Rio and Vida Limited's taxable period came to an end on 21 May 2022 (section 15E(4)), whereas it would not have ended until 30 June 2022 if the liquidation had not occurred. Edwin will need to file GST returns for the period from 21 May 2022 but is not responsible for Rio and Vida Limited's shortened taxable period from 1 May 2022 to 21 May 2022 (although he may choose to file GST returns for the shortened period subject to any other arrangements that may be in place).

Example 3: Bankruptcy scenario 1 – bankrupt operates taxable activity with the consent of the Official Assignee

Patrice runs a childcare business as a sole trader and is registered for GST. Patrice is adjudicated bankrupt on 7 July 2022. The Official Assignee is administering the bankruptcy. All of Patrice's property has been vested in the Official Assignee (sections 101 and 102 of the IA 2006). Patrice asks the Official Assignee for consent to continue to operate the business/taxable activity. The Official Assignee agrees but on the condition that Patrice agrees to file GST returns and pay GST in respect of the taxable activity.

In such circumstances the Official Assignee is not a specified agent, and Patrice is still the registered person in respect of the taxable activity with all the associated GST obligations.

Example 4: Bankruptcy scenario 2 – the Official Assignee conducts the bankrupt's business

The same facts of the bankruptcy apply as in Example 3, but here the Official Assignee turns down Patrice's request to continue to operate the business. Instead, the Official Assignee identifies a potential buyer, Scholes and Hargreaves Limited, and decides to carry on Patrice's business itself based on the reasoning that doing so will be necessary or advantageous in order to dispose of it to the buyer (Schedule 1(i) of the IA 2006). In such circumstances the Official Assignee will be a specified agent of an incapacitated person and will have GST obligations for the agency period, which will end with the sale to Scholes and Hargreaves Limited.

Example 5: Receiver carrying on part of an incapacitated person's taxable activity

Anderson Limited is GST registered and conducts a variety of business activities, including running a gym. Ryan has lent money to Anderson Limited in relation to the purchase of gym equipment and has a general security agreement (GSA) over the equipment and other property of the gym. Anderson Limited is in default under the loan and Ryan exercises her power to appoint a receiver, Luis. Luis only takes over the business of the gym; the remainder of Anderson Limited's activities remain under its control.

Anderson Limited is an incapacitated person as it has gone into receivership. Luis is a specified agent as he is carrying on a taxable activity as receiver of an incapacitated person. However, under section 58(1B) Luis is only treated as being a registered person carrying on the taxable activity of Anderson Limited in respect of the gym and not the other parts of Anderson Limited's taxable activity.

Example 6: Receiver and liquidator both carrying on part of an incapacitated person's taxable activity

Following on from Example 5, Anderson Limited's financial woes continue and a liquidator, Fletch, is appointed to protect and realise assets not subject to the GSA being administered by the receiver (Luis). Fletch is also a specified agent in respect of part of the incapacitated person's taxable activity. Fletch as liquidator and Luis as receiver are each responsible as specified agents for the supplies made and received in respect of their separate parts of the incapacitated person's taxable activity, pursuant to the rule in section 58(1B).

Example 7: Receiver and liquidator are both appointed but the receiver is carrying on the whole of the incapacitated person's taxable activity

Terry Limited is a GST registered company that is in financial distress. Pursuant to a GSA a receiver, Park, is appointed and, in fulfilling her role as a receiver, is authorised to carry on Terry Limited's taxable activity (business). At the same time a liquidator, Shea, is appointed to, amongst other things, protect the interests of unsecured creditors. As Park is carrying on the whole of the incapacitated person's (Terry Limited's) taxable activity, the rule in section 58(1B) would not apply and instead the general rule in section 58(1A) applies to ensure that Park is responsible for all the GST obligations of the taxable activity during the agency period.

Example 8: Other incapacity

Cris operates a coffee cart as a sole trader and is a GST-registered person. Cris is involved in an accident on 15 August 2022 and is in a coma in hospital and incapacitated. Cris' immediate family agree that the best thing to do while Cris recovers is to invite Cris' best friend Carrick to take over running the coffee cart. Carrick agrees and operates the coffee cart soon after the date of the accident.

Carrick is the specified agent of Cris (an incapacitated person) and will have GST obligations for the agency period (from 15 August 2022) until Cris is no longer incapacitated and is able to operate the taxable activity again (or until Carrick is no longer the specified agent **or** until someone else carries on the taxable activity).

Example 9: Distribution of taxable activity

After a couple of months it is clear that Cris (from Example 8) will not be able to carry on the coffee cart business in the medium term. Carrick is asked to sell the business and finds a buyer in Wes. The sale of the taxable activity may be a zero-rated supply of a going concern under section 11(1)(m) assuming all the requirements of that provision are satisfied.

Example 10: Mortgagee in possession

Wayne operates a Christmas tree business on a plot of land that he bought with finance from Alex. Alex has a mortgage over the land. Wayne's business has struggled to the point that Alex has exercised the right as mortgagee to take possession of the land and other property associated with the business.

Alex advises the Commissioner of the fact that Alex is now carrying on the taxable activity that Wayne previously carried on. Alex gives this notification within 21 days of taking over Wayne's taxable activity. The Commissioner exercises the discretion in section 58(2) to deem Alex to be a registered person in respect of the taxable activity from the date Alex took possession until the date Alex is no longer in possession. Wayne is no longer treated as the registered person in respect of this taxable activity.

References

Legislative references

Goods and Services Tax Act 1985

11(1)(m), 11(1)(mb), 15E, 46(7), 58, 60

Insolvency Act 2006

101, 102, 149; Schedule 1(i)

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 23/05: Provisional tax – impact on salary or wage earners who receive a one-off amount of income without tax deducted

Question | Pātai

What are the provisional tax implications when a person earning salary or wages subject to PAYE receives a one-off amount of income without any tax withheld and their residual income tax (RIT) is over $5,000?

Answer | Whakautu

A salary or wage earner who receives an amount of income without tax withheld and whose RIT is over $5,000 is a provisional taxpayer even if their RIT in the previous year was $5,000 or less.

If the RIT is $60,000 or more, the person will be exposed to use-of-money interest (debit interest) from their third instalment date (P3) on any unpaid RIT.

If their RIT is less than $60,000, the person will not have exposure to debit interest provided they pay the RIT on or before the terminal tax date.

If their tax position is automatically calculated, Inland Revenue will treat them as required to pay provisional tax in the following year under the standard method, unless they elect to use the estimation method. Before each instalment date, Inland Revenue will notify them of the tax they need to pay.

If they self-assess, they will need to indicate in their return of income what provisional tax method they will use for the following year.

If their RIT in the following year is $5,000 or less, they will not be a provisional taxpayer unless they elect to use the estimation method. If they have not estimated and choose to not pay the amounts advised to them at each instalment date but pay any current year RIT by the terminal tax date, they will not incur debit interest or late payment penalties.

Late payment penalties can apply if instalments of provisional tax are under paid or paid late and RIT is more than $5,000.

This QWBA does not consider the use of tax pooling.

Key terms | Kīanga tau tāpua

ACC earner's levy: Money paid by employees and self-employed to ACC towards the costs on non-work personal injury cover.

Estimation option: A method of calculating provisional tax based on an estimate of what the current year's RIT might be.

Late Payment Penalty (LPP): May be charged on late paid and underpaid instalments of provisional tax.

Provisional tax: Income tax usually paid as three instalments (P1-P3) for a tax year.

Residual income tax (RIT): Income tax liability minus PAYE and other tax credits other than Working for Families Tax Credits.

Standard Option: The default method of calculating provisional tax, based on previous year's RIT plus 5% or 10%.

Tax Year: 1 April to 31 March.

Terminal tax date: Generally, 7 February of the following tax year.

Use-of-money interest: Money charged on late or underpaid tax (**debit interest**), or money paid on overpaid tax (**credit interest**).

Explanation | Whakamāramatanga

1. This QWBA has arisen because salary or wage earners can sometimes receive a significant one-off lump sum amount of income without tax deducted at source, such as:
   - bright-line income (The bright-line property rule (ird.govt.nz)) arising from sale of a property; or
   - an amount of recovered depreciation on the sale of a rental property; or
   - beneficiary income from a trust where the beneficiary has agreed to pay tax rather than the trustee under section HD 4(b) of the Income Tax Act 2007 (ITA); or
   - shares transferred to an employee under an employee share scheme where the employer has chosen not to deduct PAYE (however, if the employer chooses to deduct PAYE, this QWBA does not apply to this form of income); or
   - gains the person has made on the redemption or sale of a bond that they have acquired at a discount to face value; or
   - investment income, such as Portfolio Investment Entity (PIE) or interest income, taxed at an incorrectly notified rate; or
   - a sale of shares acquired with the intention of sale.
2. Because a person in this situation has PAYE deducted at source on their normal income and do not usually have RIT over $5,000, they may not have previously been a provisional taxpayer.
3. If they continue as a salary or wage earner in the tax year in which they receive the one-off amount of income, they will not be classed as a "new provisional taxpayer" under the Tax Administration Act 1994 (TAA) (identified as a "person who has an initial provisional tax liability" under the ITA). However, if the one-off income amount without tax deducted results in RIT that is over $5,000, the person will become a provisional taxpayer (as defined in the TAA) because they are a person who is liable to pay provisional tax under s RC 3(1) of the ITA.
4. It is common for people in this situation (who have self-assessed or had their income for the tax year automatically calculated and assessed by 7 July) to have had RIT of $5,000 or less in the year before they receive the one-off amount of income. This means that s RC 3(3) of the ITA applies, so they have "no obligation to pay provisional tax" in the income year in which they derive the one-off amount of income.
5. This QWBA explores what having "no obligation to pay provisional tax" means in a practical sense and what the consequences are in terms of interest and penalty exposure if a person does not pay provisional tax or pays it voluntarily when their RIT is $60,000 or more. It also examines the implications for a person if their RIT is less than $60,000. Finally, it discusses the provisional tax consequences in the following tax year in both these situations and then provides some examples.

How provisional tax rules apply to a one-off amount of income where no tax has been deducted

6. A salary or wage earner with PAYE deducted at source will become subject to the provisional tax rules if they have RIT that is over $5,000 in any tax year. Section RC 3(1) of the ITA makes such a person liable to pay provisional tax for that tax year, so they are a "provisional taxpayer" as defined in s 3(1) of the TAA. A person who is liable to pay provisional tax then has a choice of methods to calculate the tax payable under s RC 5 of the ITA. For a salary or wage earner receiving a one-off income amount, the choice is practically limited to the standard method or the estimation method. If no other method is selected the person defaults to the standard method.
7. If that person has had RIT of $5,000 or less in the previous tax year, s RC 3(3) of the ITA applies, and they will have "no obligation to pay provisional tax" in the relevant tax year. The intention behind this provision is to provide flexibility for taxpayers who will often have difficulty predicting whether they will receive income that has had no or insufficient tax deducted. It does not, however, remove them from the obligation to follow the provisional tax rules as they keep their status as a provisional taxpayer under the TAA by being "liable to pay provisional tax" under s RC 3(1) of the ITA, despite having no obligation to pay provisional tax under s RC 3(3) of the ITA.

8. A person who chooses to pay provisional tax under s RC 4 of the ITA is also treated under s RC 3(1)(b) of the ITA as a person liable to pay provisional tax. Section RC 2(2) of the ITA re-emphasises that "the provisional tax rules apply to a person who is required or who chooses to pay provisional tax". Choosing to pay can help the person to limit their exposure to use-of-money interest (debit interest) when residual income tax is $60,000 or more.

How provisional tax rules apply when residual income tax is $60,000 or more

9. Because RIT was $5,000 or less in the previous year, a salary or wage earner who has RIT of $60,000 or more because they received income without tax deducted at source has no obligation to pay provisional tax on instalment dates. However, they may still be liable for debit interest if they don't make payments. Such a person may choose to make voluntary payments of the expected RIT amount by the last instalment date (P3) under section 120KBB of the TAA. This will limit the person's exposure to debit interest.

10. To be eligible for relief from debit interest, the person must be an "interest concession provisional taxpayer". Section 120KBB(4)(a) of the TAA defines this term:

> **interest concession provisional taxpayer** means a person that is liable to pay provisional tax for an income year if—
>
> (i) the person uses 1 of the standard methods described in section RC 5(2) or (3) of the Income Tax Act 2007 for the tax year:

11. Under s 120KBB of the TAA, a person who uses the standard method and pays their current year RIT by the last instalment payment (P3), will not have any exposure to debit interest. For taxpayers with a standard 31 March balance date, these provisional tax instalments are on 28 August (P1), 15 January (P2) and 7 May (P3).

12. From the 2019/2020 income year, a person who uses the standard method and who expects their RIT to be $60,000 or more may, under s RC 10(5), pay that expected amount (less the amounts they were liable to pay at P1 and P2, if any) on P3 (usually on 7 May) to manage exposure to debit interest.

13. If the person had no RIT assessed in the previous year or their RIT was $5,000 or less in that year, their instalment payments using the standard method at P1–P3 will be zero on each occasion. The standard method is the default option, so there is no need to advise that it has been adopted. The person can then pay the entire RIT for the current year on P3 and not be exposed to any debit interest. If they underpay the RIT they will be exposed to debit interest from P3; if they overpay it, they will be entitled to credit interest (depending on the prevailing rate) from P3.

14. If they did have RIT over $5,000 in the previous year, then they must pay the amounts required on P1 and P2 plus top up to the full RIT amount at P3, so that they are not exposed to debit interest. They will also incur LPPs on any overdue payments. These are 1% the day after the due date and 4% seven days later.

How provisional tax rules apply when residual income tax is under $60,000

15. Where their income without a tax deduction results in RIT of less than $60,000, salary or wage earners may take advantage of the use-of-money interest safe harbour under s 120KE of the TAA by paying all the RIT on or before the terminal tax date. In this context, the use-of-money safe harbour means the person will not have to pay any debit interest where they pay their RIT in full by the terminal date; nor will they be entitled to any credit interest for overpayments. For most taxpayers with a standard 31 March balance date, the terminal date is 7 February in the following year. This date can be extended if their income tax account is linked to a tax agent with an extension of time.

16. From the 2023 tax year and later years a person who uses the standard method and has RIT of less than $60,000 will meet the criteria for this safe harbour even if they miss making a provisional tax payment on time prior to the terminal tax date. Such provisional tax payments would be required if their RIT was over $5,000 in the previous tax year. However, this use-of-money safe harbour does not extend to LPPs which can still be imposed on under payments of provisional tax. Consequently, there remains an incentive to make any required provisional tax payments by their due date when RIT is under $60,000 but over $5,000.

Application of provisional tax rules when estimation occurs

17. When a person chooses the estimation method, they are exposed to debit interest on any shortfall at each instalment date if their RIT for that year is over $5,000 and they will receive credit interest for payments in excess of their RIT. They are also obliged to revise their estimate during the year to ensure it is accurate if their RIT is over $5,000. LPPs apply to overdue payments.

18. Salary or wage earners can change from the standard option to the estimation option at any time up until their final instalment (P3). But once a change is made, they cannot change back for the same tax year. If a change is made to the estimation method part way through a tax year under s RC 7 of the ITA, they will be liable to pay their RIT on each of the P1-P3 dates. Debit interest will be payable on any amounts unpaid at these dates.

Provisional tax consequences in the following tax year

19. As a result of having RIT that is over $5,000 in a tax year, a person may have an obligation to pay provisional tax and will be assumed to be filing an IR3, in that following year. If their tax position has been automatically calculated, Inland Revenue will advise them in that following tax year to pay provisional tax on instalment dates based on the standard method unless they choose to use the estimation method. A person can inform Inland Revenue of their choice of the estimation method using secure email via myIR or by phone or letter. If they make a return of income in the tax year when they received the one-off income and their RIT was over $5,000, they must in that return indicate which provisional tax method they will adopt for making payments in the following tax year.
20. Frequently the person will not be expecting to have RIT of more than $5,000 in that following year but the advised payments under the standard method are based on an uplift of either 105% or 110% of their previous year's RIT.
21. From the 2023 tax year no debit interest is charged if any RIT is less than $60,000 and the amount is paid by the terminal tax date. However, if RIT is more than $5,000, LPPs are payable on any shortfalls at each of P1-P3 on the lesser of one third of current year RIT and the payments advised to be made under the standard method in the following year.
22. Consequently, a salary or wage earner who is not expecting to have any RIT in that following year or RIT that is $5,000 or less, might choose to not pay the instalments advised to them under the standard method at P1-P3 but make sure they pay their current year RIT on or before the terminal tax date. If a person in this situation chooses not to pay, they will still be notified by Inland Revenue of the need to pay at each instalment by myIR, via their agent or by mail.
23. Alternatively, they may choose to adopt the estimation method and estimate their provisional tax at nil and then make no payments at each instalment in that following year. This choice has exposure to debit interest and LPPs at each instalment date if there is in fact any RIT for that following year.

How to include one-off income in a return of income

24. A person who has income from only salary, wages, benefits, taxable pensions, interest, or dividends may be automatically assessed. If the information on their income is incomplete, it is that person's responsibility to correct it plus add any other income and make any required disclosure. An automatically assessed return becomes an IR3 if that return is altered, and additional income types are added. This is a seamless process, particularly through a digital channel such as myIR or via a tax agent. If a person is registered with myIR, they receive their automatic assessment and all relevant information through myIR. If they are not registered, they receive the automatic assessment by mail. If the person has a tax agent, all communication occurs through that agent who will be directly linked to Inland Revenue.

Bright-line income

25. When an automatically assessed person has made a property sale within a bright-line period, they will usually receive a notification from Inland Revenue (via myIR, their tax agent or mail) that they may have a bright-line tax liability (the property sale within the bright-line period notification process). In response, they will need to review the information and update it if required. They must then include any resulting income in a return of income unless the person has responded to the notification advising that the property is not taxable under the bright-line rules. They can also provide this advice at filing time by removing the pre-populated bright-line indicator and selecting the reason why bright-line does not apply.
26. If the person needs to disclose a property sale, they can – at their own initiative –add a property sales information form, *Bright-line property sale information* IR833 (Inland Revenue Department NZ, August 2020), in myIR or via a tax agent's link. The net profit from the property sale is then included in the return of income in the residential income box.
27. For more details, go to: https://www.ird.govt.nz/updates/news-folder/pre-population-in-31-03-2022-income-tax-returns---ir833

Employee share scheme income

28. When a salary or wage earner receives income without a tax deduction from an employee share scheme and their employer advises Inland Revenue, it will show up in their myIR as part of the salary, wages, benefits and taxable pension section in the relevant month. Unlike their regular salary or wage, no PAYE will be deducted in the column alongside it. It will also be included in the column as Earnings not liable for ACC (Accident Compensation Corporation earners' levy).

29. The amount will then be automatically included in the total gross income amount from salary, wages, benefits and taxable pensions. It will therefore be included in the person's taxable income for the relevant tax year unless their employer neglects to advise Inland Revenue.

Sale of a financial arrangement

30. Where a person has sold or disposed of a financial arrangement, they should complete *Sale or disposal of financial arrangements* IR3K (Inland Revenue Department NZ, May 2021) and attach this to an IR3 as part of their return of income. This presents as a 'tick the box' option under *select secondary forms you wish to file* when the person is completing a return of income in myIR for the relevant period.

Other income

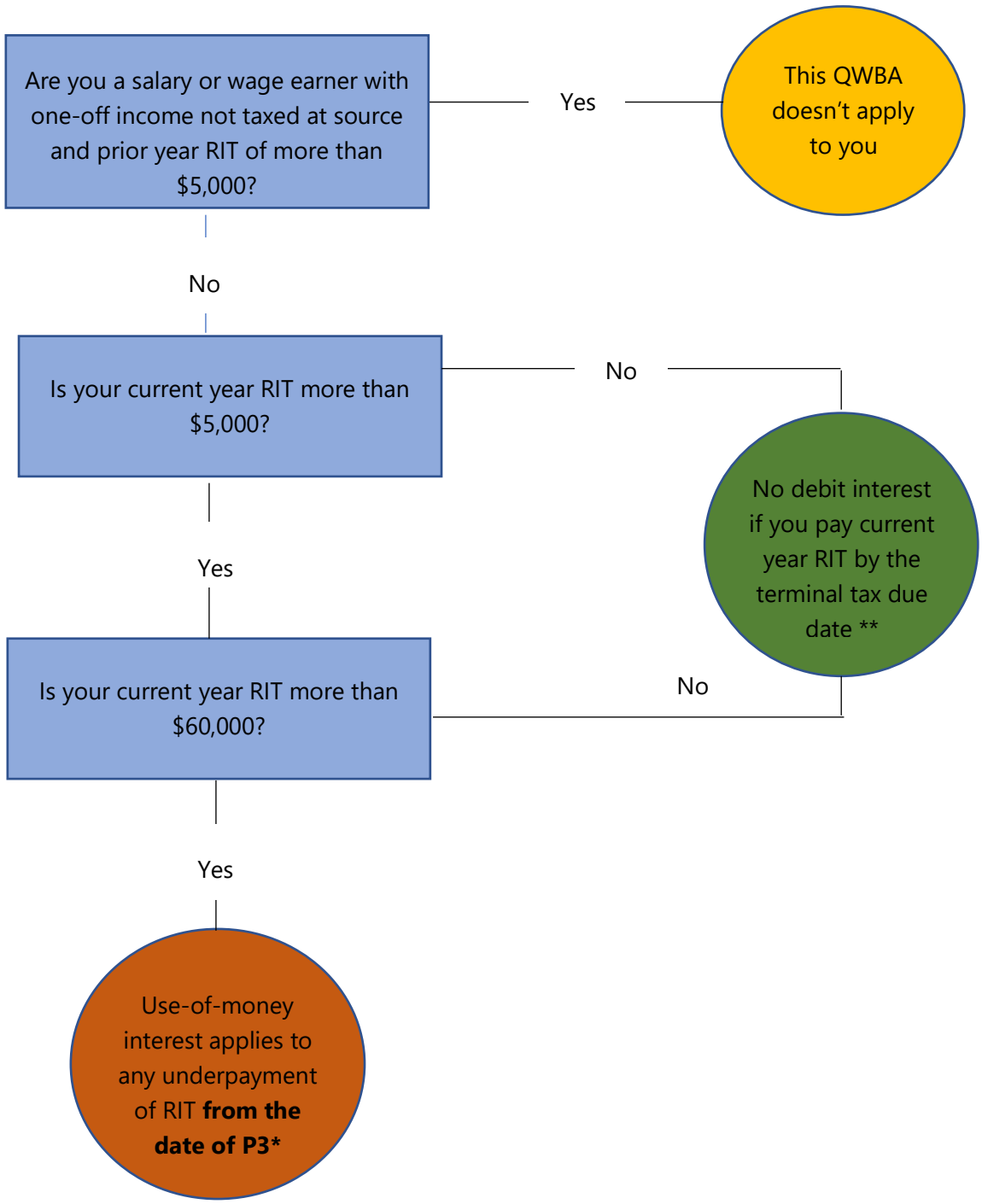
31. Other one-off income amounts such as a sale of shares acquired with the intention of sale can be included in the box identified as "other income" when completing a return of income. The return of income may already indicate that Inland Revenue holds information suggesting the person has other income for that tax year, but the person remains responsible for entering the relevant detail.

Summary

32. Where a salary or wage earner receives a one-off income amount that is not taxed at its source and their RIT is over $5,000, the impact of the provisional tax rules depends on the amount of that RIT. The first situation applies to a salary or wage earner who receives income without tax deducted at source resulting in RIT of $60,000 or more in a tax year and who did not have RIT over $5,000 in the previous year. In this case, they will have exposure to debit interest if they do not pay all the RIT by P3. P3 is 7 May for taxpayers with a standard 31 March balance date.
33. The second situation applies to a salary or wage earner who receives income without tax deducted resulting in RIT less than $60,000, and who did not have RIT over $5,000 in the previous year. In this case, they will not be exposed to debit interest if they pay the RIT on or before the terminal tax date. The terminal tax date is 7 February the following year for taxpayers with a standard balance date.
34. In both situations highlighted above LPPs may apply to under payments and the person will be obliged to pay provisional tax in the tax year after receiving the one-off amount. If Inland Revenue automatically calculated their tax position, it will advise them in the following year to pay provisional tax on instalment dates based on the standard method, unless they elect to use the estimation method. Alternatively, if the person files a return of income, they pay provisional tax under the standard method unless they opt to use the estimation method.
35. If the person does not expect to derive any further income without tax deducted in the following year, they could choose not to pay the provisional tax payments advised to them. From the 2023 tax year and later income years provided their RIT in that following year is less than $60,000 and it is paid by the terminal tax date, they will not be exposed to debit interest. However, if RIT is more than $5,000, LPPs are payable on any shortfalls at each of P1-P3 on the lesser of one third of current year RIT and the payments advised to be made under the standard method in the following year.
36. They may choose to adopt the estimation method for that following year, but this will expose them to debit interest on any shortfalls at each of P1–P3 if they do in fact have RIT that is over $5,000.
37. When a person who is automatically assessed has made a property sale likely to be subject to the bright-line rule, Inland Revenue will notify them, and they must file a return of income. They can also do this if they are not notified either online or by posting in the return if they are not registered or do not have a tax agent.
38. If a salary or wage earner has received employee share income without PAYE deducted and the employer has notified Inland Revenue, this will show up in their myIR as gross income from salary, wages, benefits and taxable pensions without PAYE deducted. Inland Revenue will automatically assess them on the untaxed amount if they only have interest or dividend income in addition to their salary.
39. After selling or disposing of a financial arrangement, a person should complete an IR3K as part of their IR3 return of income for that tax year.
40. For other untaxed one-off income amounts like share sales, a person may include them in the box marked "other income" in a return of income for the relevant tax year.

41. The following flowchart and examples illustrate these points.

Provisional Tax / Use of Money Interest Exposure



* If you have used the estimation method debit or credit interest and LPPs may apply from P1.

** If RIT is less than $60,000 LPPs may still apply to provisional tax payments not made.

Examples | Tauira

Example | Tauira 1 – Bright-line income that a salary or wage earner receives results in residual income tax over $60,000

Facts: Kahu is a salaried IT consultant who purchases a bach on the Kāpiti Coast for $1 million in January 2020. He sells the property in November 2021 at the market peak for $1.5 million, so makes a total gain on sale of $400,000 after deducting legal and real estate agent fees and other direct costs of $100,000.

The property is subject to the 5-year bright-line period as Kahu disposed of it within 5 years of purchasing it and acquired it before 27 March 2021 when the 5 year bright-line period increased to 10 years.

At his marginal tax rate of 39%, he has tax to pay of $156,000 on his $400,000 taxable gain on sale in the 2022 tax year.

Question: What is Kahu's liability to pay provisional tax in the 2022 and 2023 tax years and his exposure to debit interest and LPPs as a result of receiving the bright-line income while his only other income is from salary, interest and dividends?

Answer – 2022 tax year: Kahu is registered for myIR and receives a notification from Inland Revenue that he may have bright-line income in the 2022 tax year. As a salary or wage earner, Kahu does not have an "initial provisional tax liability" under s RC 9(9) of the ITA in the 2022 tax year. He has a RIT liability from the bright-line income of $156,000. Since his RIT is more than $5,000, he is "liable to pay provisional tax" under s RC 3(1) of the ITA, so is a "provisional taxpayer" under s 3(1) of the TAA. This applies even though Kahu had no RIT in the 2021 income year, so he has "no obligation to pay provisional tax" for the 2022 tax year under s RC 3(3) of the ITA.

Kahu can qualify as an "interest concession provisional taxpayer" under s 120KBB of the TAA if he uses the standard method. Because his RIT is $60,000 or more, the use-of-money safe harbour under s 120KE does not apply meaning he does not have until the terminal tax payment date before debit interest will apply.

Kahu is not exposed to debit interest until P3 but can make voluntary payments at any time between P1 and P3. On 7 May 2023 at P3 Kahu pays the $156,000 using the option in s RC 10(5). Provided he makes no other election, Inland Revenue treats Kahu as having adopted the standard method. As a result, Kahu has no exposure to debit interest.

Answer – 2023 tax year: Inland Revenue will automatically calculate Kahu's 2023 provisional tax under the standard method unless he elects to use the estimation method.

He is not expecting any income without tax deducted at source, so is reluctant to adopt the standard method, which would demand three payments of $54,600 ($156,000 x 105%).

Kahu has been advised to consider his options under s 120KE of the TAA which apply from and including the 2023 tax year. It limits exposure to debit interest for those using the standard method who have RIT less than $60,000 to RIT unpaid from the terminal tax date. He will still have exposure to LPPs if his RIT is over $5,000 at each instalment date (P1-P3) but these are based on the lesser of the standard method payment required and one third of the RIT.

Kahu's other option is to adopt the estimation method and then not make any instalments on the assumption he will not have any RIT in the 2023 tax year. If Kahu adopts the estimation method, he must give a fair and reasonable estimate of his RIT and he must inform Inland Revenue of the estimate on or before P1.

Kahu's tax agent advises him that if Kahu does use the estimation method, he needs to consider the risks. If Kahu does have some RIT to pay in the 2023 tax year, including from untaxed income that unexpectedly arises, he has until the date of P3 to re-estimate his 2023 provisional tax when he becomes aware of this income. The revised estimate will apply to the remaining 2023 provisional tax payments. Provisional tax cannot be re-estimated after the due date of P3.

Under the estimation option Kahu will have an exposure to debit interest at each instalment date equal to the current year RIT amount divided by three, less any amounts paid. Kahu can make voluntary payments at the time of revising his estimate to help mitigate any debit interest for instalments already paid or use tax pooling funds at backdated effective dates within the applicable time frames.

Kahu would need to notify his nil estimate on or before P1. Otherwise, if he does not pay $54,600 by P1, he risks LPPs if his 2023 RIT is more than $5,000. Even if Kahu's 2023 RIT is not more than $5,000, by not paying by P1 Kahu also risks LPPs if his 2023 RIT is later reassessed to be more than $5,000. Faced with these risks Kahu decides not to estimate.

Kahu's tax agent suggests Kahu is probably best advised to not make the provisional tax instalments under the standard method and instead pay any current year RIT by the terminal tax date because he is not expecting to have any RIT and will not be exposed to debit interest on the instalments (P1-P3) unless his RIT is $60,000 or more.

The tax agent explains that Kahu will face LPP risks if his 2023 RIT turns out to be more than $5,000. LPPs are calculated on the lesser of the payment required under the standard method and one third of the RIT at each instalment date (P1-P3).

Example | Tauira 2 – One-off income amount that a salary or wage earner receives results in residual income tax of $60,000 or more

Facts: Jackie is the chief executive of Goboy Ltd with a salary of $180,000 per year and no RIT in the 2021 tax year. In December 2021 Goboy advises her that she is immediately entitled under the executive share scheme to shares in Goboy with a market value of $200,000. Goboy elects not to treat this benefit as subject to PAYE but still reports it to Inland Revenue as a benefit under the PAYE rules. Jackie receives the benefit as income not taxed at source in the 2022 tax year.

Question: What is Jackie's liability to pay provisional tax in the 2022 and 2023 tax years and her exposure to debit interest and LPPs as a result of receiving that benefit when she continues throughout this time as a salaried chief executive?

Answer – 2022 tax year: As Jackie never ceases being an employee, she will not have an "initial provisional tax liability" under s RC 9(9) of the ITA in the 2022 tax year. She will have a RIT liability on the share benefit of $78,000. Because her RIT is more than $5,000, she is "liable to pay provisional tax" under s RC 3(1) of the ITA, so is a "provisional taxpayer" under s 3(1) of the TAA. This applies even though Jackie had no RIT in the 2021 tax year, so she has "no obligation to pay provisional tax" for the 2022 tax year under s RC 3(3) of the ITA.

Jackie can qualify as an "interest concession provisional taxpayer" under s 120KBB of the TAA if she uses the standard method. Because her RIT is $60,000 or more, the use-of-money safe harbour under s 120KE does not apply meaning debit interest can apply prior to the terminal tax payment date.

Jackie is not exposed to debit interest until P3 but since P1 was in the past she can make voluntary payments at any time between P2 and P3. Her best option would be to make a voluntary payment of the amount she expects to be her 2022 RIT on P3 (7 May 2021) as she will have exposure to debit interest from that date on any under payments (and will get credit interest for any overpayment) of her actual 2022 RIT from P3.

Answer – 2023 tax year: Inland Revenue will automatically calculate Jackie's 2023 provisional tax under the standard method unless she elects to use the estimation method. She is not expecting any further benefits under the Goboy executive share scheme, nor any other income without tax deducted at source, so is reluctant to adopt the standard method, which would demand three payments of $27,300 ($200,000 x 39% x 105%).

But Jackie considers her options under s 120KE of the TAA which apply from and including the 2023 tax year. It limits exposure to debit interest for those using the standard method who have RIT less than $60,000 to RIT unpaid from the terminal tax date. She will still have exposure to LPPs if her RIT is over $5,000 at each instalment date (P1-P3) but these are based on the lesser of the standard method payment required and one third of the RIT.

Jackie decides to not make the payments she is advised by Inland Revenue to make under the standard method at P1 to P3. She is confident that any RIT is likely to be under $5,000 and that she will not have any exposure to LPPs and should be able to make full payment on the terminal tax date without an exposure to debit interest.

Example | Tauira 3 – One-off income amount that a salary or wage earner receives results in residual income tax of less than $60,000

Facts: The facts are the same as in Example 2 except Jackie's share entitlement is worth only $100,000 so her RIT in 2022 is $39,000.

Question: What are the provisional tax and debit interest implications for the 2022 and 2023 tax years?

Answer – 2022 tax year: Jackie has RIT of $39,000 so she is a provisional taxpayer under s RC 3(1) of the ITA. This applies even though she has no obligation to pay provisional tax under s RC 3(3) of the ITA on the grounds that she had RIT of $5,000 or less in the 2021 tax year. Jackie qualifies under s 120KE of the TAA for payment of the RIT on the terminal tax date for the 2022 tax year because her RIT in 2022 was under $60,000. Jackie's only exposure to debit interest will occur if she does not pay the RIT amount on the terminal tax date.

Answer – 2023 tax year: Inland Revenue will automatically calculate Jackie's tax position in the 2023 year and will treat her as liable to pay provisional tax based on the standard method unless she elects to use the estimation method. As she is not expecting another share scheme benefit or any other income untaxed at source, Jackie decides not to make the instalments at P1-P3 for the 2023 tax year. Provided her RIT for 2023 is under $60,000 she will qualify for the safe-harbour concession under s 120KE of the TAA that applies from and including the 2023 tax year. This means she will only be exposed to debit interest on any underpayments of RIT on the 2023 terminal tax date despite not making the instalment payments.

However, if there is any RIT for 2023 that is over $5,000 Jackie will be exposed to LPPs for amounts short paid at each of the P1-P3 instalments.

Alternative Answer - 2023 tax year: Assume Jackie's mother dies unexpectedly on the 20th of January 2023 and Jackie is entitled under her will to rental income from an industrial building for the period from death until 31 March 2023. An amount of $60,000 is distributed from this to Jackie as beneficiary income from her mother's estate on 30 April 2023. The executor has no knowledge of Jackie's tax position, so Jackie agrees to pay tax on the distribution under s HD 4(b) of the ITA rather than the executor deducting tax from the distribution and paying it to Inland Revenue.

Jackie was not anticipating receiving this income and did not pay any of the provisional tax advised to her at P1 or P2 before her mother died. Her tax liability on $60,000 at 39% is $23,400. She understands that as her RIT is less than $60,000, she will still qualify for the use-of-money interest concession under s 120KE of the TAA that applies from and including the 2023 tax year. So, she has until the 2023 terminal tax date of 7 February 2024 to pay the $23,400 before debit interest will apply.

However, Jackie is now liable for LPPs at both P1 and P2. The LPPs are 1% the day after due date and 4% seven days later. The LPPs are imposed on the lesser of the payments she was advised to make under the standard method ($39,000 x 105% divided by 3= $13,650) and one third of her actual RIT ($23,400/3 = $7,800). Therefore, she incurs LPPs of 5% on $7,800 = $390 on each of the missed payments at P1 (28 August 2022) and on P2 (15 January 2023). To avoid a further LPP of $390 Jackie decides to pay her RIT on P3 (7 May 2023) and not delay until the terminal tax date.

Had Jackie advised the executor to deduct tax of $23,400 from the distribution made to her and pay this across to Inland Revenue she would not have the LPP liability of $780 or the need to pay the RIT herself. The LPPs are treated as unpaid tax and will attract debit interest if not paid by the terminal tax date.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Income Tax Act 2007, ss s HD 4(b), RC 2(2), RC 3, RC 4, RC 5, RC 7, RC 9(9), RC 10(2), RC 10(5), RC 12

Tax Administration Act 1994, ss 3(1), 120KB, 120KBB, 120KE

Other references | Tohutoro anō

Inland Revenue Department NZ, *Bright-line property sale information* IR833 (August 2020) https://www.ird.govt.nz/-/media/project/ir/home/documents/forms-and-guides/ir800---ir899/ir833/ir833-2021.pdf

Inland Revenue Department NZ, *Individual tax return* IR3 (March 2022) https://www.ird.govt.nz/-/media/project/ir/home/documents/forms-and-guides/ir1---ir99/ir3/ir3-2022.pdf

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TECHNICAL DECISION SUMMARIES

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

TDS 23/04: Losses carried forward and debt remission income

Technical decision summary | Adjudication

Decision date | Rā o te Whakatau: 23 September 2022

Issue date | Rā Tuku: 26 April 2023

Subjects | Kaupapa

Losses carried forward; shareholder continuity breach; Assessability of debt remission income; Liability for shortfall penalty for taking an unacceptable tax position

Abbreviations | Whakapotonga

The abbreviations used in this document include:

CCS	Customer & Compliance Services, Inland Revenue
Commissioner	Commissioner of Inland Revenue
ITA 2007	Income Tax Act 2007
CSOP	Commissioner Statement of Position

Taxation laws | Ture tāke

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

Facts | Meka

1. The Taxpayer was a limited liability company that was placed in interim liquidation and receivers appointed.
2. The receivers returned debt remission income in the 2012 tax return for the Taxpayer.
3. A shareholding change in the Taxpayer took place in the 2012 tax year. A further shareholding change was alleged by Customer Compliance Services Inland Revenue (**CCS**) to have taken place in the 2013 tax year.
4. In the 2013 tax return the Taxpayer claimed an adjustment to reverse the debt remission income returned in the 2012 tax year.
5. In the Commissioner's Statement of Position (**CSOP**), CCS proposed to reduce the tax losses carried forward by the Taxpayer in the 2013 and 2014 tax years because of breaches in ownership continuity and proposed an unacceptable tax position shortfall penalty for each year. The reversal of the "debt remission income adjustment" in the 2013 tax year was also proposed in the CSOP as an alternative adjustment.

Issues | Take

6. The main issues considered in this dispute were:
   - whether the Taxpayer satisfied the ownership continuity requirements to carry forward losses;
   - whether the Taxpayer derived debt remission income for the 2012 tax year (and if not, whether the debt remission income returned for the 2012 tax year can be "reversed" by a negative "debt remission income adjustment" for the 2013 tax year); and
   - whether the Taxpayer is liable for a shortfall penalty for taking an unacceptable tax position as a result of the Taxpayer having failed to satisfy the ownership continuity requirements to carry forward losses for each of the 2013 and 2014 tax years.

Decisions | Whakatau

7. TCO decided that:
   - The Taxpayer had breached the continuity requirements for the 2012 tax year, but CCS had not proposed any adjustments for that period.
   - The Taxpayer had derived debt remission income for the 2012 tax year, and the "debt remission income adjustment" for the 2013 tax year (by which the Taxpayer sought to "reverse" the debt remission income returned for the 2012 tax year) should be reversed as proposed by CCS.
   - There is no relevant tax shortfall in either period on which to impose a shortfall penalty as the Taxpayer took the correct tax position in each of the 2013 and 2014 tax years.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Ownership continuity requirements to carry forward losses.

8. The issue was whether the Taxpayer had lost the ability to carry forward losses because the Taxpayer had failed to satisfy the ownership continuity requirements to do so.
9. CCS claimed that the Taxpayer had not satisfied the ownership continuity requirements to carry forward various losses because of shareholding changes in June 2012 and June 2013.
10. The Taxpayer maintained there had been no breach in its ownership continuity up to the end of the 2017 tax year, and that the Taxpayer was entitled to carry forward its losses for the respective income years.
11. Subpart IA governs the use of tax losses. If certain requirements are met, a company can carry forward a tax loss to a subsequent tax year to reduce the company's net income (if any) or to be added to the tax loss for the subsequent tax year. A tax loss carried forward for a preceding tax year may include tax loss components carried forward from earlier tax years. Tax loss components included in a tax loss must be used in the order in which they arose.
12. There is a continuity requirement to carry forward a tax loss in s IA 5. Ownership continuity is determined by identifying the minimum ownership interest held by an owner during the continuity period. Ownership interests are measured in terms of voting interests, and if a market value circumstance exists, market value interests. The ownership continuity requirement must be satisfied for each tax loss component that makes up a tax loss and for the continuity period applying to that component.
13. TCO concluded that the Taxpayer had satisfied the ownership continuity requirements to carry forward losses for the period from 1 July 2000 to 30 June 2011. This meant the Taxpayer was able to carry forward net losses for the 2001 to 2009 tax years in a loss balance for use against net income for the 2010 and 2011 tax years. The amount that can be so used is, in terms of the ordering rule, made up of tax loss components that are net losses for the 2001 and 2002 tax years, and part of the net loss for the 2003 tax year.
14. However, there was a shareholding change in the Taxpayer in June 2012. The result was that the Taxpayer had not satisfied the ownership continuity requirements to carry forward losses for the periods from 1 July 2002 to 30 June 2012, 1 July 2003 to 30 June 2012, and 1 July 2004 to 30 June 2012. This meant the Taxpayer could not carry forward the net loss that had not already been used for the 2003 tax year, and the net losses for the 2004 and 2005 tax years, in a loss balance for use against net income for the 2012 tax year. These losses had been "lost." However, CCS had not proposed any adjustments for the 2012 tax year (seemingly not having recognised the effect of the 30 June balance date, and incorrectly focussing on the 2013 tax year).

15. Subsequent to a second change in shareholding in the Taxpayer in June 2005, the Taxpayer had satisfied the ownership continuity requirements to carry forward tax losses for the period from 1 July 2005 to 30 June 2012. This meant the Taxpayer could carry forward the net loss for each of the 2006 to 2009 tax years in a loss balance for use against the net income for the 2012 tax year.
16. There was no change in the shareholding in the Taxpayer in June 2013, applying s YC 9. This meant to the extent the Taxpayer had a net loss for the 2013 tax year, the Taxpayer was able to carry forward the net loss in a loss balance for use against net income for the 2014, 2015 and 2017 to 2020 tax years.
17. In summary, CCS had correctly identified that there was a shareholding change in the Taxpayer in June 2012, but there was no shareholding change in June 2013. As a result, the Taxpayer had failed to meet the ownership continuity requirements to carry forward losses for a number of continuity periods, but the effect was for the 2012 tax year (with 15 June 2012 within the Taxpayer's income year (1 July 2011 to 30 June 2012) that corresponds to the 2012 tax year) and CCS had not proposed any adjustments for the 2012 tax year.

Issue 2 | Take tuarua: Debt remission income

18. This issue was whether the Taxpayer had derived debt remission income for the 2012 tax year, and if not, whether the amount could be reversed for the 2013 tax year.
19. Under s CC 3, if a person who is a party to a financial arrangement is treated as deriving an amount of income under the financial arrangement under subpart EW (Financial arrangement rules), the amount is income of the person.
20. One of the purposes of the financial arrangement rules (FARs), under s EW 1(3)(c), is "to require a party to a financial arrangement to calculate a base price adjustment when the rights and obligations of the party under the arrangement cease." Under s EW 3(3), "a debt, including a debt that arises by law" and "a debt instrument" are financial arrangements. Under s EW 28, a party to a financial arrangement who must calculate a base price adjustment, as described in s EW 29 and EW 30, calculates it using the formula in s EW 31.
21. Under s EW 29(9) "a party to a financial arrangement must calculate a base price adjustment as at the date on which a party to the arrangement is discharged from making all remaining payments under the arrangement without fully adequate consideration". Section EW 46C applies in certain circumstances where a debt is remitted within an economic group, to the extent to which an amount of debt is remitted.
22. Under the general law and s 14(2) of the Receiverships Act 1993, the Joint Receivers and Managers (Receivers) of the property of the Taxpayer and the creditors had the power to discharge the Taxpayer's debt to the creditor.
23. The discharge was a bilateral discharge, with the Receivers acting for both the Taxpayer, as debtor, and the creditor. The Taxpayer's financial statements for the year ended 30 June 2012 evidence the agreement between the parties to the debt that the debt be discharged, with the amount forgiven recorded as "Debt Written Off" sundry revenue in the Taxpayer's statement of financial performance for the year ended 30 June 2012.
24. As the Receivers acted for both sides of the transaction, the discharge of the debt cannot be invalidated under s 16 of the Receiverships Act. In any event, the Taxpayer had not appeared to have sought to invalidate the transaction; for tax purposes, or more generally (instead merely seeking to reverse the tax effect through returning a negative "debt remission income adjustment" for the following tax year).
25. The tax consequences of the discharge of the debt (in that the Taxpayer's remaining debt to the creditor had been forgiven) was debt remission income to the Taxpayer of the amount remitted for the 2012 tax year, as correctly returned. Section EW 46C did not apply to prevent this outcome (so the taxpayer's "reversal" of the debt remission income in 2013 is incorrect, as argued by CCS).

Issue 3 | Take tuatoru: Unacceptable tax position shortfall penalty

26. The Taxpayer's loss balance to carry forward for each of the 2013 and 2014 tax years was unaffected by the Taxpayer's failure to satisfy the ownership continuity requirements to carry forward losses. There was no relevant tax shortfall in either period on which to impose a shortfall penalty.
27. The Taxpayer's tax position as to the availability of a tax loss component or loss balance to carry forward for the 2013 tax year was incorrect because of the correctness of the proposed adjustment to reverse the Taxpayer's "debt remission income adjustment" for the 2013 tax year. However, no shortfall penalty had been pursued by CCS for this adjustment.

TECHNICAL DECISION SUMMARIES

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TDS 23/05: In-specie distribution of assets upon winding-up of a unit trust

Technical decision summary | Private ruling

Decision date | Rā o te Whakatau: 2 February 2023

Issue date | Rā Tuku: 1 May 2023

Subjects | Kaupapa

Income Tax: dividend; in-specie distribution of assets; winding-up of unit trust; on the liquidation of a company.

Taxation laws | Ture tāke

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

Facts | Meka

1. The Applicant is a unit trust, as defined in s YA 1 (Unit Trust). The Unit Trust's assets consist of investments in New Zealand and overseas. The assets were funded from introduced capital and realised and unrealised capital gains on investments.
2. The sole unit holder of the Unit Trust (Unitholder) will provide written consent to the Trustee of the Unit Trust to determine (terminate) the Unit Trust (Date of Consent).
3. In the course of winding up the Unit Trust, the Trustee will transfer the assets held by the Unit Trust in-specie to the Unitholder.

Issues | Take

4. The issue considered in this ruling is whether the in-specie distribution by the Unit Trust of its assets to the Unitholder in the course of winding up is a non-taxable distribution under ss CD 26 and CD 44.

Decisions | Whakatau

5. The Tax Counsel Office (TCO) concluded that any in-specie distribution by the Unit Trust of its assets to the Unitholder after the Date of Consent will not be a dividend under s CD 26, to the extent to which the distribution consists of available subscribed capital calculated under ss CD 23 and CD 43 or an available capital distribution amount calculated under s CD 44.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: In-specie distribution of assets upon winding up of a unit trust

6. Under s CD 4, a transfer of company value from a company to a shareholder is a dividend if the cause of the transfer is a shareholding in the company and none of the exclusions in ss CD 22 to CD 37 apply.
7. Section CD 26 relevantly provides that an amount paid to a shareholder in relation to a share on the liquidation of a company is only a dividend to the extent to which it is more than the available subscribed capital (ASC) per share (defined in s CD 43), or the available capital distribution amount (ACDA) (defined in s CD 44).

Is the Unit Trust a company?

8. A company is expressly defined as including a unit trust (s YA 1). Similarly, a share is defined as including a unit in a unit trust (s YA 1). A shareholder is defined as including a holder of a share (s YA 1), which given the other definitions would include the holder of a unit in a unit trust.
9. Given the Unit Trust is a unit trust as defined in s YA 1, the Unit Trust will be treated as a company for tax purposes, and the units in the Trust will be treated as shares. On that basis, references to a company, share or shareholders in s CD 26 refer to the Unit Trust, the units in the Unit Trust and the holders of the units in the Unit Trust respectively.

"On the liquidation of the company"

10. As noted, under s CD 26 an amount paid to a shareholder on the liquidation of a company is only a dividend to the extent to which it is more than the ASC or ACDA.
11. The Applicant confirmed that the distribution will consist only of ASC and ACDA, therefore, it was not necessary for TCO to consider these concepts further.
12. The only issue to be considered for the application of s CD 26 was when, in the context of a unit trust, an amount is paid "on the liquidation of the company".
13. The definition of "liquidation" in s YA 1 refers to the liquidation process in the Companies Act and to the termination of the company's existence under any other procedure of New Zealand or foreign law. The definition also refers to the concept of "anything occurring on liquidation", and states that it is anything occurring during the period that starts with a step that is legally necessary to achieve liquidation and that is for the purpose of liquidation.[1]
14. The winding-up process for a unit trust must also start with a step, or overt action, that is legally necessary and made to achieve liquidation, rather than for any other purpose.
15. Under trust law, there are several ways a trust can be terminated, including upon the trustees exercising a discretion to vest all of the trust funds in the beneficiaries.
16. Under the Trust Deed of the Unit Trust, the Trustee may, with the consent of a special majority of unit holders, determine (terminate) the Trust on the first day of the accounting period next following any such direction. That date is treated as the Vesting Day, which is defined in the Trust Deed to mean the date for final distribution of the trust fund.
17. TCO considered that the first step legally necessary to achieve the termination (or determination) of the Unit Trust is the provision of written consent by the Unitholder to the Trustee to determine the Unit Trust, that is, the Date of Consent. That will be the step that begins the process referred to in the ITA as "on liquidation" for the Unit Trust.
18. Therefore, any distributions made after the Date of Consent will be made "on the liquidation of the company" and will not be dividends to the extent they consist of ASC or ACDA.
19. On that basis, TCO concluded that any in-specie distribution by the Unit Trust of its assets to the Unitholder after the Date of Consent will not be a dividend under s CD 26, to the extent to which the distribution consists of ASC calculated under ss CD 23 and CD 43 or an ACDA calculated under s CD 44.

1 See BR Pub 14/09: *Meaning of 'Anything occurring on liquidation' when a company requests removal from the Register of Companies* and QB 20/03: *First step legally necessary to achieve liquidation when a liquidator is appointed*

TECHNICAL DECISION SUMMARIES

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TDS 23/06: Deductibility of payment to settle legal proceedings

Technical decision summary | Adjudication

Decision date | Rā o te Whakatau: 2 February 2023

Issue date | Rā Tuku: 4 May 2023

Subjects | Kaupapa

Deduction from assessable income; payment for settlement of legal proceedings

Abbreviations | Whakapotonga

The abbreviations used in this document include:

CCS	Customer & Compliance Services, Inland Revenue
Commissioner	Commissioner of Inland Revenue
ITA 2007	Income Tax Act 2007
CNOR	Commissioner Notice of Response
TCO	Tax Counsel Office, Inland Revenue
TNOPA	Taxpayer Notice of Proposed Adjustment

Taxation laws | Ture tāke

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

Facts | Meka

1. The Taxpayer is involved in a number of businesses that primarily relate to property development including being involved as a director of numerous companies.
2. They are also involved as an employee of one company. Their salary as an employee was their only source of income returned for the 2018, 2019 and 2020 tax years, and main source of income for the 2021 tax year (and 2022 tax year up to 18 August 2021).
3. One of the businesses that the Taxpayer was involved with was put into liquidation and legal proceedings were initiated by the Liquidators against the business, the Taxpayer (as a Director) and other parties.
4. The proceedings were settled out of court with an agreement between the Liquidators and the Taxpayer (and the other parties), requiring the Taxpayer to pay to the Liquidators a significant sum referred to as the Settlement Amount.

5. The Taxpayer proposed an adjustment to their 2020 income tax return to include a deduction for the Settlement Amount in a Taxpayer's Notice of Proposed Adjustment (**TNOPA**) on the basis that:
   - they paid the amount to protect their reputation within the property development industry; and
   - their reputation was an essential part of his income-earning activities.
6. Customer & Compliance Services, Inland Revenue (**CCS**) rejected the proposed adjustment in the TNOPA in a Commissioner's Notice of Response (**CNOR**). In the CNOR, CCS said that no proof of payment of the Settlement Amount had been provided and the Settlement Amount did not have the necessary nexus to the Taxpayer's income to be deductible.
7. The Taxpayer maintained the position taken in their TNOPA in a Taxpayer's Statement of Position and a Commissioner's Statement of Position was issued to the Taxpayer in which CCS maintained the position taken in the CNOR, rejecting the Taxpayer's position that the Settlement Amount is deductible.
8. This dispute was referred to the Tax Counsel Office, Inland Revenue (**TCO**) for review

Issues | Take

9. The main issues considered in this dispute were:
   - Had the Taxpayer incurred the Settlement Amount?
   - Does the Settlement Amount have the necessary nexus with the Taxpayer's assessable income to be deductible under the general permission under s DA 1 and if so, does the private limitation under s DA 2(2), the capital limitation under s DA 2(1) and/or the employment limitation under s DA 2(4) apply to prohibit any deduction?

Decisions | Whakatau

10. TCO decided that:
    - The Taxpayer had incurred the Settlement Amount. The Taxpayer was under a legal obligation to pay the amount, and became definitively committed to the expenditure, upon execution of the Settlement Agreement.
    - The Settlement Amount was not deductible to the Taxpayer and the Settlement Amount was not sufficiently linked to satisfy the nexus test, so deductibility was denied under the private and capital limitations. Even if the Settlement Amount was sufficiently linked to the Taxpayer's employee income to be deductible, the employment limitation would have prevented deductibility.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Deductibility of the Settlement Amount

11. Section DA 1 contains the general rule allowing deductions for expenditure or loss. The general rule is called the general permission.
12. There are two alternative grounds under which a deduction is allowed (sometimes referred to as the first and second limbs of s DA 1). A deduction is allowed for expenditure or loss incurred by a person:
    - in deriving their assessable income, or
    - in the course of carrying on a business for the purpose of deriving their assessable income.
13. The alternative grounds are not cumulative. Expenditure or loss will be deductible under s DA 1 if only one of the alternative grounds is met.
14. For an amount of expenditure to be incurred by a person, the person must have either paid or become definitively committed to the amount. To be definitively committed to the amount:
    - the amount must constitute an existing obligation;
    - the amount must be more than merely impending, threatened or expected; and
    - theoretical contingencies can be disregarded.

15. Section DA 2 provides the general limitations. Each of these overrides the general permission and denies a deduction for an amount of expenditure or loss to the extent that it is:
    - of a capital nature (Capital limitation)
    - of a private or domestic nature (Private limitation)
    - incurred in deriving income from employment (Employment limitation)
16. TCO derived the following principles in respect to the deductibility of expenses incurred by a person (including to protect their reputation):
    - The expenses must have a sufficient nexus with the derivation of the person's assessable income or a business carried on for the purpose of deriving the person's assessable income (*Banks*[1], *Buckley & Young*[2]);
    - Whether an expenditure has the necessary nexus is a matter of degree and so a question of fact *(Banks, Buckley & Young)* based on a pragmatic approach and common sense and business realities *(Europa Oil*[3], *Cox*[4], *P v CIR*[5]);
    - The heart of the inquiry into nexus is the identification of the relationship between the advantage gained or sought to be gained and the income earning process. This in turn requires determining the true character of the payment (*Buckley & Young);*
    - The true character of a payment depends on what the expenditure is calculated to effect from a practical and business point of view *(Hallstroms*[6], *McElwee*[7], *P v CIR);*
    - A sufficient nexus can exist between expenditure and a person and the carrying on of a business for the purposes of generating that person's assessable income even though the personal interests of those employed or otherwise involved in the business are also advanced *(Magna Alloys & Research*[8]);
    - A hazard of a person conducting business through a company is that business expenditure incurred by the person will likely relate to the company's income earning process and not that of the person *(McElwee, Case S5, Case T9)*;
    - Expenditure need not produce income in the year of deduction *(Ward, Cox)*; and
    - It is not necessary to be able to trace through to an identifiable item or amount of income (*Cox*).
    - Expenses to protect reputation will have a sufficient nexus to a person's income earning process if that income earning process is essential to, or dependent to a substantial degree on, the reputation of the person (*Case M121*[9], *Case N4*[10], *P v CIR*);
    - A person's reputation is not a capital item or private or domestic in nature if a person's reputation is an essential ingredient for the person to be able to earn income (*Case N4, Cox*);
    - Legal proceedings can relate to actions not within the scope or course of the person's income earning process (*Case M121*);
    - In assessing the value of a person's reputation, evidence of regular income from self-employment, the person's professional activities and experience along with evidence of any detriment they have or would have suffered is required in assessing the nexus between the expenditure incurred and the income earning process that is being protected (*Case M121, Case N4, P v CIR, Cox, Case T9*[11]
    - A person who only derives employment income will be unable to deduct payments to protect their business reputation (*Case M121, Case T9, Case U29*[12], *s DA 2(4)* (employment limitation)).

1 *CIR v Banks* [1978] 2 NZLR 472; (1978) 3 NZTC
2 *Buckley & Young Ltd v CIR* [1978] 2 NZLR 485; (1978) 3 NZTC 61,271 (CA).
3 *Europa (No Oil (NZ) Ltd 2) v C of IR* (1974) 1 NZTC 61,169 (Court of Appeal)
4 *Cox v CIR* (1992) 14 NZTC 9,164 (HC).
5 *P v CIR* (No 2) (1998) 18 NZTC 13,647 (HC).
6 *Hallstroms Pty Ltd v FCT* (1946) 8 ATD 190 (HCA).
7 *McElwee v CIR* (1997) 18 NZTC 13,288 (HC).
8 *Magna Alloys & Research Pty Ltd v FCT* (1980) ATC 4,542 (FCAFC).
9 *Case M121* (1990) 12 NZTC 2,773 (TRA).
10 *Case N4* (1991) 13 NZTC 3,030 (TRA).
11 *Case T9* (1997) 18 NZTC 8,049 (TRA).
12 *Case U29* (2000) 19 NZTC 9,273 (TRA)

17. TCO concluded that the Taxpayer had incurred the Settlement Amount. Although the Taxpayer had not provided evidence to show that they had paid the amount, the Taxpayer was under a legal obligation to pay the Settlement Amount, and became definitively committed to the expenditure, upon execution of the Settlement Agreement.
18. However, the Settlement Amount was not deductible to the Taxpayer for the following reasons:
    - The Taxpayer was not a self-employed professional director and did not derive any income from their activities as a director.
    - The Settlement Amount had not been incurred by the Taxpayer in the course of gaining or producing income, or to preserve their ability to continue to earn income, as a director.
    - While there was some connection between the Settlement Amount and the Taxpayer's income earning activities, the connection was not strong enough, or sufficient, to achieve deductibility of the Settlement Amount.
    - The Taxpayer's salary had been derived by them for their services to their employer from funds gained by the employer through its own income earning process.
    - Any dividend paid to the Taxpayer was related to the Taxpayer's shareholding in the relevant company rather than to the payment of the Settlement Amount.
    - The expenditure in question related directly to the income earning process of the companies through which the Taxpayer operated, but not, in any direct sense, to the Taxpayer's assessable income.
19. That the expenditure in question was not sufficiently linked to the Taxpayer's income earning process to be deductible was also determinative of the collateral issues of whether the expenditure was not deductible under the private and/or capital limitations. The expenditure did not satisfy the nexus test. It was of a private or domestic nature, and capital in nature, and was not deductible under the private and capital limitations.
20. Even if the Settlement Amount was sufficiently linked to the Taxpayer's employee income to be deductible, the employment limitation prevented deductibility. Under the employment limitation, a person is not allowed a deduction for expenditure to the extent to which it is incurred in deriving income from employment.

TECHNICAL DECISION SUMMARIES

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TDS 23/07: Whether expenditure to resolve weathertightness issues is deductible

Technical decision summary | Adjudication

Decision date | Rā o te Whakatau: 20 January 2023

Issue date | Rā Tuku: 5 May 2023

Subjects | Kaupapa

Income tax: capital limitation; repairs and maintenance; weathertightness repairs.

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
TCO	Tax Counsel Office, Inland Revenue

Taxation laws | Ture tāke

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

Facts | Meka

1. The Taxpayer is an individual who owns a rental property.
2. The rental property is a unit (the Unit), which is part of a block of 6 units (the Block). The Block is part of a complex (the Complex) consisting of other similar blocks and other dwellings. The Block operates as a free-standing building within the Complex. The units within the Block are connected by inter-tenancy walls.
3. The Block was largely clad with monolithic cladding. The Block (along with the other blocks in the Complex) required remediation work to resolve weathertightness issues. This remediation work (Remediation) was carried out by the body corporate (the Body Corporate) and paid for by special levies payable by each unit holder calculated by reference to their expected portion of the total expenditure.
4. The Unit was untenanted while the Remediation was carried out. The Taxpayer independently organised for internal painting to be done to the Unit (Painting) while the property was untenanted.

Issues | Take

5. The main issues considered in this dispute were whether the capital limitation in s DA 2(1) applied to deny a deduction for expenditure claimed by the Taxpayer for the special levies and the Painting in the disputed periods
6. There was also a preliminary issue on the onus and standard of proof.

Decisions | Whakatau

7. The Tax Counsel Office (**TCO**) decided that the capital limitation applied to deny a deduction for the special levies claimed for the Taxpayer's share of the cost of the Remediation. However, the capital limitation did not apply to deny a deduction for the cost of the Painting.

Reasons for decisions | Pūnga o ngā whakatau

Preliminary issue | Take tōmua: Onus and standard of proof

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

Issue 1 | Take tuatahi: Whether the capital limitation applies

10. The issue is whether expenditure claimed by the Taxpayer for Remediation incurred as special levies paid to the Body Corporate, and for the cost of painting incurred directly by the Taxpayer, is capital and therefore not deductible by virtue of the capital limitation in s DA 2(1).
11. Customer & Compliance Services, Inland Revenue (**CCS**) considered that all of the expenditure claimed, including that for the Painting, was capital, as the scope of the Remediation involved the reconstruction of the whole asset, or at the very least, changed the character of the asset. CCS argued that the Painting was part of the overall Remediation project and is therefore capital expenditure.
12. The Taxpayer considered that the expenditure was on revenue account and therefore deductible or, alternatively, it was appropriate to apportion the expenditure. The Remediation was primarily limited to certain portions of the inter-tenancy walls and decks, and the rest of the units were intact and weathertight. The Taxpayer stated the Painting was carried out independently by the Taxpayer and did not form part of the Remediation. The Taxpayer argued the Painting was therefore ordinary repairs and maintenance expenditure.
13. The parties did not dispute that the expenditure met the requirements of the general permission in s DA 1.

Capital limitation

14. The general permission is overridden by the general limitations in s DA 2 (s DA 2(7)). The relevant general limitation in the present dispute is the capital limitation in s DA 2(1).
15. In applying the capital limitation, it is necessary to distinguish between revenue expenditure (potentially deductible) and capital expenditure (not deductible because of the capital limitation). One of the seminal cases on how to distinguish between the two types of expenditure is *BP Australia*.[6] The Privy Council in *BP Australia* set out the factors to determine the nature of an expense.[7]

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

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

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

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

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

6 *BP Australia Ltd v CT* [1965] UKPCHCA 2, (1965) 112 CLR 386.

7 See *CIR v McKenzies New Zealand Limited* (1988) 10 NZTC 5,233 (CA) at 5,236 for a summary of these factors.

16. TCO considered there are three elements from the general application of the *BP Australia* principles to remediation expenditure that are most relevant to determining if an expenditure is of a revenue or capital nature. These are:[8]
    - Whether the work done resulted in the reconstruction, replacement or renewal of the asset, or substantially the whole of the asset.
    - Whether the work done had the effect of changing the character of the asset.
    - Whether the work was part of one overall project or was a series of projects that merely happened to be undertaken at the same time.
17. TCO considered that the following analysis was consistent with the Commissioner's position in IS 12/03 *Income tax-deductibility of repairs and maintenance expenditure – general principles.*

Repairs and maintenance expenditure

18. The crux of the issue is whether the expenditure is caught by the capital limitation in the context of repairs and maintenance expenditure.
19. The Privy Council case of *Auckland Gas*[9], the leading New Zealand decision on the tax treatment of repairs and maintenance expenditure, adopted a two-stage process when determining whether the expenditure is of a revenue or capital nature:
    - First, the asset being repaired or worked on is identified.
    - Second, the nature and extent of the work done to that asset is analysed.

Stage one: identify the asset

20. TCO considered the cases that addressed how to identify the asset being repaired or worked on[10], and inferred the following principles from these cases:
    - It is a question of fact and degree as to what constitutes a single asset. However, the focus is on identifying what constitutes the entirety of the asset. This involves identifying the "physical thing which satisfies a particular notion".
    - Identifying the asset is not about identifying the profit-earning structure or entity. The fact that a particular physical thing realises its economic value only when used in conjunction with other things or a business operation does not mean it cannot be the relevant asset on which the work is undertaken.
    - A single asset may be made up of interdependent parts. There is a potential danger of distortion if too large or too small an asset is identified. The entirety of the asset must be identified by itself. It will not be an aggregation of things.
    - Identifying whether a part of a wider asset is itself a separate physical thing, or merely a component of the wider asset, includes considering whether the item is physically and functionally distinct from the wider asset. That is, it is relevant to consider:
        - whether there is a degree of physical connection between the component parts, and
        - whether the components are necessary to carry out the asset's function.
    - Subsidiary parts of an integrated system form part of that system rather than being assets in their own right. Something that is integral to a larger asset's ability to function is unlikely to be the relevant asset that is worked upon.

Stage two: nature and extent of the work done

21. The second step is to consider the nature and extent of the work done on the asset. The three elements to determining if an expenditure is of a revenue or capital nature, mentioned in [16] above, are discussed here.

    Whether the work done resulted in the reconstruction, replacement or renewal of the asset, or substantially the whole of the asset.

8 These elements will be discussed further below.

9 *CIR v Auckland Gas Co Ltd* (1999) 19 NZTC 15,011 (CA) at 15,702.

10 *Auckland Gas* at 15,707; *Lindsay v FCT* (1961) 106 CLR 377 (HCA); *Poverty Bay Electric Power Board v CIR* (1999) 19 NZTC 15,001 (CA); *Auckland Trotting Club (Incorporated) v CIR* [1968] NZLR 967 (CA); *Hawkes Bay Power Distribution Ltd v CIR* (1998) 18 NZTC 13,685 (HC); *Case N8* (1991) 13 NZTC 3,052; *Case F67* (1983) 6 NZTC 59,897.

22. If the work done resulted in the reconstruction, replacement or renewal of an asset, the expenditure is likely to be of a capital nature. This is contrasted with renewal or replacement of subsidiary parts of a whole.[11] In applying this test, the work done to the asset must be looked at in its totality to decide whether the work done is so substantial that the whole, or substantially the whole of the asset is reconstructed, replaced or renewed. This may include work done over more than one income year.[12]

Whether the work done had the effect of changing the character of the asset.

23. If the nature and scale of the work done to an asset indicates that the work has gone beyond repairs, and has changed the character of the asset, the cost of that work is capital expenditure.[13] In contrast, work that merely restores an asset to its original condition will be of a revenue nature. Key factors to consider include:

- The use of new materials in completing the work does not necessarily mean that the asset is improved.[14] However, where different materials are used, and as a result the asset is more advantageous or performs or functions better or differently than it did previously, this may indicate a change in the character of the asset.[15] Where a decision is made to use better materials instead of the same or equivalent materials, a change in the character of the asset will result and the expenditure will be of a capital nature.[16]
- Changes to an asset's value, earning capacity, useful life, or function or operating capacity, whether or not a goal of the work done, cannot be relied on in isolation to establish the nature of the work done to the asset. But in some cases, the courts have used such factors to support an overall assessment of whether the character of an asset has changed.[17]
- Determining the scale of the work done includes a consideration of the extent of the work done, the importance of the work done to the asset and the business, as well as the cost of the work done. The greater the extent of the work done, the greater the importance of the work done to the asset and the business, and the more significant the costs incurred, the more likely the expenditure will be of a capital nature.[18]

Whether the work was part of one overall project or was a series of projects that merely happened to be undertaken at the same time.

24. Where remediation forms part of one overall capital project, it is not appropriate to separate the different costs for tax purposes. Rather, all of the expenditure should take its nature from that of the overall project. [19] However, there may be some situations where apportionment is appropriate. For example, a taxpayer may do work on an asset while at the same undertaking an overall project. If it can be demonstrated that the work done is not part of that project, the nature of the work must be determined on its own facts. Consequently, if that work does not reconstruct, renew or replace an asset or substantially the whole of an asset or change its character the expenditure on that work is likely to be revenue in nature and deductible. [20]

Was the Painting part of the Remediation?

25. TCO first considered the nature of the Painting and whether it was part of the Remediation project. This is because if the Painting was part of the overall Remediation project, as CCS alleged, then whether the Painting was on its own deductible would not be relevant.

26. TCO considered the Painting was not part of the overall Remediation project as it was separate maintenance work that was, from the information provided, contracted, invoiced and paid for by the Taxpayer completely separately from the special levies for the Remediation.

11 *Lurcott v Wakely & Wheeler* [1911] 1 KB 905. See *Auckland Trotting Club* at 205; *Hawkes Bay Power* at 13,707; *Case J92* (1987) 9 NZTC 1,518 at 1,522.

12 See *Auckland Gas, Poverty Bay Electric Power* and *Hawkes Bay Power.*

13 *Auckland Gas* at 15,706–15,707

14 *Conn (HMIT) v Robins Bros Ltd* (1966) 43 TC 266 (Ch).

15 *FCT v Western Suburbs Cinemas Ltd* (1952) 86 CLR 102 (HCA).

16 *Auckland Gas* at 15,708

17 *Case X26* (2006) 22 NZTC 12,315; *Colonial Motor Company Ltd v CIR* (1994) 16 NZTC 11,361 (CA).

18 *Auckland Gas* at 15,706; Case L68 (1989) 11 NZTC 1,398; *Hawkes Bay Power* at 13,706-13,707.

19 *Colonial Motor; Sherlaw v CIR* (1994) 16 NZTC 11,290

20 *Hawkes Bay Power*

27. Accordingly, from a practical and business point of view, the Painting was not part of the Remediation project. The only connection with the Remediation is that both were carried out at the same time.
28. Therefore, the deductibility of the Painting was considered separately from the deductibility of the special levies.

The Remediation

29. The parties' arguments focused on whether the Remediation expenditure incurred by the Body Corporate was of a revenue or capital nature. As the special levies were calculated by reference to the Taxpayer's share of the Remediation expenditure, TCO considered that the levies would take the character of that expenditure.
30. Regarding the first stage of the two-stage approach in *Auckland Gas*, the parties disagreed as to whether the relevant asset was the Unit, the Block, or the entire Complex. TCO considered that the relevant asset subject to the Remediation work was the Block. The Unit was not the asset because at issue is the nature of the expenditure incurred by the Body Corporate, which concerned work on the blocks within the Complex on a block-by-block basis. The work was not carried out solely within the boundaries of the Unit. The Complex was also not the asset due to the lack of physical and functional connection between the blocks and the fact that the project only concerned particular parts of the entire Complex. The Complex was not a physical thing which satisfied a particular notion.
31. The Remediation included, among other things, repair and replacement of damaged timber framing in the exterior portions of the inter-tenancy walls, re-cladding of the exterior portions of the inter-tenancy walls to make them less prone to weathertightness issues (including the installation of new connections, junctions and flashings for those walls), rebuilding of decks with moisture and structural issues (including the installation of new balustrades, connections and flashings), replacement of membrane roofs over certain windows, and providing additional clearance between the cladding and the ground.
32. Regarding the nature and scope of the Remediation done to the Block, TCO concluded the following:
    - The Remediation did not result in the reconstruction, replacement, or renewal of the Block or substantially the whole of the Block. While the work done to some affected parts of the Block was arguably extensive, those areas are not so significant a part of the Block that the work done could constitute a reconstruction, renewal, or replacement of the whole, or substantially the whole, of the asset. However, the expenditure would still be capital if the nature and scale of the remedial work had the effect of changing the character of the asset.
    - After weighing up the various factors, the nature and scale of the work done was such that it changed the character of the Block because the cost of the Remediation was high (around 20% of the value of the units in the Complex), and there were clear, significant improvements to the affected areas, some of which were structurally significant and important to the operation of the asset. In addition, the remediation of the Block was necessary to prevent water ingress and protect the overall structural integrity and income-earning capacity of the Unit and the rest of the Block.

The Painting

33. As the Painting was not part of the Remediation project, its tax treatment was considered on its own facts.
34. TCO considered the Painting did not result in the reconstruction, replacement or renewal of the whole of or substantially the whole of the Unit, the Block or the Complex, and it did not change the character of any of them. The purpose of the Painting was to restore the internal walls to the state they were in when the Unit had originally been freshly painted. The Painting was maintenance work that must be done regularly to keep a rental property in good condition. This was indicative of the Painting being a revenue expense.

Overall conclusion

35. The capital limitation applied to deny a deduction for the special levies claimed by the Taxpayer for their share of the cost of the Remediation. However, the Painting was a revenue expense and was, therefore, deductible in accordance with s DA 1.

REGULAR CONTRIBUTORS TO THE TIB

Tax Counsel Office

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

Legal Services

Legal Services manages all disputed tax litigation and associated challenges to Inland Revenue's investigative and assessment process including declaratory judgment and judicial review litigation. They contribute the legal decisions and case notes on recent tax decisions made by the Taxation Review Authority and the courts.

Technical Standards

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

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Policy advises the Government on all aspects of tax policy and on social policy measures that interact with the tax system. They contribute information about new legislation and policy issues as well as Orders in Council.