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TAX INFORMATION

Bulletin

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Inland Revenue
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YOUR OPPORTUNITY TO COMMENT

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

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Tax Counsel Office
Inland Revenue PO Box 2198 Wellington 6140

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Your opportunity to comment

Ref	Draft type	Title	Comment deadline
PUB00435	Interpretation statement	Research and development loss tax credits	30 August 2023

IN SUMMARY

New legislation

Ruling

Interpretation statements

Technical decision summary

NEW LEGISLATION

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

Public Act 2023/27 – Child Support (Pass On) Acts Amendment Act 2023 – Special Report

Amendments overview

The amendments made under the Child Support (Pass On) Acts Amendment Act 2023 ensure that beneficiaries receiving a sole parent rate of main benefit are not treated differently from other beneficiaries. From 1 July 2023, child support collected by Inland Revenue will be paid to those beneficiaries, and the Ministry of Social Development (MSD) will then treat these payments as income when determining entitlement to a benefit or other assistance.

Previously, parents and carers who received a sole parent rate of main benefit were required to apply for child support to be assessed and collected by Inland Revenue. Child support payments collected by Inland Revenue on behalf of these sole parent beneficiaries were retained by the government to offset the cost of their benefits. Once the cost of their benefit had been offset, any excess was paid to the beneficiary. Excess payments were not treated as income by MSD when determining the sole parent's benefit entitlement. However, other beneficiaries (such as repartnered beneficiaries) had their child support passed on. This created inequity and inconsistency between how sole parent beneficiaries and other beneficiaries were treated in the benefit system.

To correct this, the obligation for sole parent beneficiaries to apply for child support to be assessed and collected by Inland Revenue has been removed. Any child support payments collected by Inland Revenue will be passed on to sole parent beneficiaries. These changes do not apply to Unsupported Child's Benefit beneficiaries.

MSD will treat the child support payments passed on by Inland Revenue as income when determining the beneficiary's eligibility to, or rate of, benefit. Monthly child support will be spread across four or five weeks. This process will be automated using information provided by Inland Revenue under its approved information sharing agreement.

Related to the amendments outlined above, formula assessments of child support payable by liable parents are now costs that can be considered for Temporary Additional Support and Special Benefit purposes.

The Child Support (Pass On) Acts Amendment Act 2023 implements the first of two phases – passing on child support and treating most child support payments as income. The second phase would implement rules for how child support payments are treated as income in rarer cases and may come into effect at a later date.

Effective date

All the proposed amendments take effect on 1 July 2023.

Amendments to the Child Support Act 1991

Passing on child support

Sections 141 to 143 of the Child Support Act 1991

Child support assessed and collected by Inland Revenue for parents or carers receiving a sole parent rate of main benefit is no longer retained and is passed on to the receiving carer.

Background

Child support is money paid by parents who do not live with their children or who share care with someone else. The money is to help with the cost of raising a child. One of the main objects of child support is to ensure children are maintained by their parents.

Parents and carers receiving a sole parent rate of main benefit were required to apply to Inland Revenue for a formula assessment of child support, and child support payments collected by Inland Revenue on their behalf were retained by the government to offset the cost of their benefit.

Once the full cost of their benefit was offset, any remaining child support payment was paid to them.

These settings did not apply to other beneficiaries. For example, parents on a couple's rate of main benefit who have children in their care from a previous relationship receive any child support payments in full, with none of it retained by the government.

Key features

The amendments ensure child support payments collected by Inland Revenue for parents or carers receiving a sole parent rate of main benefit are no longer retained by the government. Instead, child support payments are passed on in the same way they are passed on to other beneficiaries.

Requirement to apply for child support through Inland Revenue removed

Sections 9, 12 and 27 of the Child Support Act 1991

Parents receiving a sole parent rate of main benefit are no longer required to apply for formula assessed child support through Inland Revenue.

Background

Parents and carers receiving a sole parent rate of main benefit were required to apply for a formula assessment of child support through Inland Revenue, unless one of the grounds for exemption (such as a risk of violence) applied.

This requirement did not apply to other beneficiaries with children or other parents outside the benefit system.

Key features

The requirement that parents receiving a sole parent rate of main benefit apply for child support has been removed. This enables carers to enter the type of child support arrangement that best meets their needs – whether this is a formula assessment, a voluntary agreement, a private arrangement, or no child support arrangement at all.

Amendments do not apply to people receiving an Unsupported Child's Benefit

Sections 2, 50, 96Y, 122, 131, 152B and 179A to 180A of the Child Support Act 1991

The amendments that pass on child support payments and remove the requirement to apply for child support through Inland Revenue do not apply to people receiving the Unsupported Child's Benefit (UCB).

Background

The UCB is administered by MSD for children living with caregivers outside the State care system. It is a payment that helps caregivers who are supporting children whose parents cannot care for them because of a family breakdown.

Caregivers who receive the UCB are required to apply for child support with Inland Revenue. Any child support payments made by liable parents are retained to offset the cost of the recipient's UCB.

Key features

The amendments that pass on child support and remove the requirement to apply for formula assessed child support do not apply to UCB recipients.

Passing on child support for caregivers receiving the UCB is being considered by Oranga Tamariki as part of the long-term work to reform the system of financial assistance and support for caregivers.

These reforms intend to transform the caregiver financial assistance system and passing on child support will be considered in the context of the new model.

The relevant sections in the Child Support Act 1991 that applied to a "social security beneficiary" have been amended to only refer to a "UCB beneficiary". This ensures that those sections continue to apply to people receiving the UCB.

Amendments to the Child Support Rules 1992 and Family Court Rules 2002

Redundant forms and rules

Rules 13, 19 and schedule 1 of the Child Support Rules 1992 and rules 21, 258, 260 and schedule 3 of the Family Court Rules 2002

The prescribed forms and other rules relating to urgent maintenance orders in the Child Support Rules 1992 and Family Court Rules 2002 are revoked.

Background

The Child Support Amendment Act 2021 revoked the provision of the Child Support Act 1991 that allowed a person to apply to the Family Court for an urgent maintenance order if they had made an application for child support to Inland Revenue, but child support had not yet been assessed.

This provision was originally included in the Child Support Act 1991 to cover the transition when child support moved to Inland Revenue in case there were unforeseen circumstances that meant Inland Revenue was unable to assess child support. However, the prescribed forms and other rules relating to urgent maintenance orders in the Child Support Rules 1992 and Family Court Rules 2002 were not revoked at the same time as the provision.

These forms and other rules have been revoked because they are redundant.

Amendments to the Social Security Act 2018 and Social Security Regulations 2018

Use of automated electronic systems

Sections 113, 296 and new Subpart 5A of Part 6 of the Social Security Act 2018 and regulations 207, 208A and 208B of the Social Security Regulations 2018

The process of considering child support payments as income is automated. Benefit debt arising from an error in the information shared by Inland Revenue, or the processing of that information by MSD is not recoverable and will be written off.

Background

Previously, any child support remaining after the full cost of a sole person's benefit was recovered was paid to the parent or carer. This child support was only income for Temporary Additional Support, Special Benefit, and Childcare Assistance.

Now that child support is no longer retained, the child support payment is income for benefits and other assistance. This is consistent with how child support paid to other beneficiaries is treated.

People receiving a benefit or other assistance have been required to tell MSD about any income they receive. MSD staff would then determine the period for which the income affects any benefits they receive and apply the income manually over that period.

Key features

The amendments allow for automation of the process to treat child support payments as income for benefits and other assistance. Automation is supported by Inland Revenue sharing child support information with MSD under their Approved Information Sharing Agreement.

The sharing of child support information by Inland Revenue means that a person's obligation to declare their income to MSD is satisfied unless the information shared is incorrect.

In the event there is a systems failure (that leads to a disruption to the disclosure of information to MSD that is used in or by the system) or specified individual errors (as set out in section 304A of the Social Security Act 2018) in the processing of the child support information provided by Inland Revenue, any resulting overpayment of benefit (debt) is not recoverable from the beneficiary and will be written off.

New definitions: "information share child support payment" and "general provisions child support payment"

Schedule 2 of the Social Security Act 2018

New definitions for "information child support payment" and "general provisions child support payment" are inserted to enable the new income-charging rules to be applied.

Background

Treating certain child support payments as income under new income rules means it is necessary to specify the child support payments the new rules apply to because there are scenarios where it is not appropriate for the child support payments to be spread as income on a forward-looking basis.

Key features

The new income rules will apply to an "information share child support payment" only (see "Child support payments treated as income" below). This is child support that is:

- money received by the person, and
- not a general provisions child support payment.

A "general provisions child support payment" will continue to be treated under the general income rules where appropriate. This is a payment that is money received by the person that is child support and is all or any of the following:

- paid in a manner other than by direct credit to a bank account
- paid to a person before they apply for and are granted a benefit or other assistance
- paid under a formula assessment paid after the full cost of a person's UCB has been recovered
- paid under a voluntary agreement paid to a person receiving a UCB
- paid under an order made by the Family Court
- foreign child support payment
- paid to a person receiving a specified New Zealand benefit while they are not living in New Zealand
- payments relating to a child support period before 1 July 2023
- child support about which Inland Revenue has not provided information to MSD, and
- any child support payments specified by regulations made under section 418(1)(na).

New section 418(1)(na) allows newly identified payment scenarios to be added to the definition of general provisions child support payment via regulations. This allows those child support payments to be treated correctly and for them to be classified in a timely manner.

Child support payments that do not come under either definition would not be income for a benefit or other assistance. For example, child support that two parents owe each other that has been netted off and is no longer payable.

Child support payments treated as income

Clauses 7A–8, 11–13, 15 and Part 3A of schedule 3 of the Social Security Act 2018

New income rules apply to "information share child support payments". The income will be spread across the next four or five weeks (depending on the number of benefit payments in a one-month period after the payment is received and whether a weekly or fortnightly benefit is being received).

"General provisions child support payments" will continue to be treated under MSD's existing general income rules.

Background

New income rules apply to information share child support payments (see "New definitions: "information share child support payment" and "general provisions child support payment" above).

Child support is a monthly payment, whereas benefit payments are paid weekly or fortnightly. Under the general income rules, MSD has a discretion to determine the period to which any income relates. This means that when MSD is made aware of a person's income, they may determine that it relates to a past or future period. If MSD determines the income relates to a past period for which the benefit has already been paid, this can result in benefit debt for the beneficiary.

Key features

The new income rules treat information share child support payments as income on a weekly basis.

This replaces how MSD treats child support payments from Inland Revenue as income for all beneficiaries, not just parents receiving a sole parent rate of main benefit.

General provisions child support payments will continue to be treated as income under MSD's existing general income rules.

Information share child support payments

Child support payments collected by Inland Revenue are based on an annual liability. This annual amount is then divided equally into 12 monthly payments due by liable parents. In contrast, benefits are paid on either a weekly or fortnightly basis.

If the monthly child support payment was only treated as income in the week or fortnight it was received, the payment may result in more benefit abatement than if the payment was spread over the length of time it is intended to represent.

The new income rules take the monthly child support payment and turn it into weekly amounts by spreading the payment evenly across the following four or five weeks after the payment is received. This ensures that entitlement to a benefit is assessed in a way that is consistent with the number of weeks the child support payment is intended to support the child.

This means that benefit entitlement will be assessed based on the financial resources available to the receiving carer and debt for families is minimised by ensuring child support payments do not impact benefits that have already been paid.

Example 1: Spreading of income

Jo is receiving a sole parent rate of benefit. Her ex-partner is paying child support of $180 each month. Previously, the government retained all the child support to offset the cost of Jo's benefit. Child support for periods from July 2023 will be passed on to Jo instead.

The child support for August 2023 is due to be paid to Inland Revenue by 20 September, and Inland Revenue passes the payment on to Jo. Rather than treating the child support as income for August, or as income in the week it is received (which would only abate Jo's benefit in that week), the payment is treated as $36 of income in each of the following five weeks.

This is different from the general income rules in the Social Security Act 2018. Those rules provide MSD with a discretion to determine the period the income is taken into account for benefit purposes.

How child support will be treated as income for benefit purposes

Whether a person is receiving their benefit weekly or fortnightly will impact the number of weeks their child support payment is treated as income as well as the start and end dates of the income treatment.

Weekly benefits

When the payment starts to be treated as income

The period of entitlement for weekly benefits runs from Monday to Sunday. The benefit payment is made to the beneficiary in the following week.

A child support payment starts to be income from the Monday of the week that the payment is treated as being received (referred to in the Social Security Act 2018 as the "deemed receipt"). A payment is treated as received on the business day after Inland Revenue notifies MSD that the payment has been made to the receiving carer.

Example 2: When payment starts to be income

Inland Revenue notifies MSD that an information share child support payment has been made to a receiving carer on 22 August 2023. The payment would be treated as being received on 23 August (being one business day after Inland Revenue notifies MSD the payment has been made). The payment would start to be treated as income for benefit purposes on 21 August – the Monday of the week the payment is treated as being received.

Mon	Tue	Wed	Thu	Fri	Sat	Sun
21 Payment starts being income	22 Payment made and MSD notified	23 Date treated as being received	24	25	26	27

If notification is sent to MSD on a Friday, the payment would be treated as being received on the following Monday, and the payment would start to be treated as income on that same Monday.[1]

Mon	Tue	Wed	Thu	Fri	Sat	Sun
21	22	23	24	25 Payment made and MSD notified	26	27
28 Date treated as being received Payment starts being income	29	30	31	1	2	3

When the payment stops being treated as income

When a child support payment stops being income for weekly benefits depends on whether it is an "in-cycle payment" or an "out-of-cycle payment".

An in-cycle payment is any child support payment made by Inland Revenue to a receiving carer on the day that is two business days after the 19th of the month. For example, if the 19th of a month is a Saturday, any child support payment that Inland Revenue pays to a receiving carer on Tuesday 22nd would be an in-cycle payment. In-cycle payments generally represent a child support payment that is on time. However, any late child support payments made on this day will also be treated as an in-cycle payment for benefit purposes.

Any child support payments made to a receiving carer on any other day of the month that is not the in-cycle payment date is an out-of-cycle payment. Using the example in the previous paragraph, if the payment was made on Monday 21st or Wednesday 23rd, the payment would be an out-of-cycle payment. Inland Revenue does not make child support payments on non-business days such as weekends or public holidays. Out-of-cycle payments represent payments for an earlier child support period that have not been paid by the due date.

When an in-cycle payment stops being treated as income

For in-cycle payments, the child support payment stops being income on the Sunday before the "expected date of the next in-cycle payment" – this is the third business day after the 19th of the following month. This rule is designed to ensure that an in-cycle payment stops being treated as income before the next payment starts to be treated as income.

1 If the day after the payment is made is a public holiday, the payment would be treated as received on the next business day.

Example 3: When an in-cycle payment stops being income

Paul is a receiving carer and is receiving a sole parent rate of main benefit. On 21 June 2024, Inland Revenue makes a $400 child support payment to Paul's bank account and notifies MSD of the payment.

The payment is treated as being received one business day after MSD is notified. In this case, because 21 June 2024 is a Friday, the payment is treated as being received on Monday 24 June. The child support starts being income on the Monday of the week the payment is treated as being received, which is also 24 June.

The expected date of the next in-cycle payment is the third business day after 19 July, which is Wednesday 24 July. The child support payment therefore stops being income on Sunday 21 July, being the Sunday before the expected date of the next in-cycle payment.

Therefore, the child support payment is income from 24 June to 21 July.

There are four weekly benefit payments between these dates. Therefore, the child support payment of $400 is divided by four. MSD will treat $100 of child support as Paul's income for each week during this period.

Mon	Tue	Wed	Thu	Fri	Sat	Sun
17	18	19	20	21 In-cycle payment made and MSD notified	22	23
24 Date treated as being received Payment starts being income	25	26	27	28	29	30
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21 Payment stops being income
22	23	24 Date we expect the next payment to be treated as received	25	26	27	28

When an out-of-cycle payment stops being treated as income

An out-of-cycle child support payment stops being income on the Sunday before the date that is the same date in the next calendar month as the deemed receipt date of the payment.

Example 4: When out-of-cycle payments stops being income

Inland Revenue makes a child support payment of $100 on 8 November 2023 to Maggie. This is an out-of-cycle payment as the payment is not made on the in-cycle payment date of 21 November (two business days after 19 November). The payment is treated as being received on the next business day, which is 9 November.

The payment starts being income from the Monday of the week the payment is treated as being received – 6 November.

The same date in the next calendar month as the deemed receipt date of the payment is 9 December. The payment stops being income on the Sunday before this date – 3 December. If the same date in the next calendar month is a Sunday, the payment still stops being income on the Sunday the week before this date.

Therefore, the period the child support payment would be treated as income would start on 6 November and end on 3 December.

There are four benefit payments between these dates. Therefore, the child support payment of $100 would be divided by four. MSD would treat $25 of child support as Maggie's income for each week during this period.

Mon	Tue	Wed	Thu	Fri	Sat	Sun
6 Payment starts being income	7	8 Out-of-cycle payment made and MSD notified	9 Date treated as being received	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30	1	2	3 Payment stops being income
4	5	6	7	8	9 Same day in the following month	10

If the date in the next calendar month does not exist, the "same" date will be the 1st of the following month.

Example 5: Out-of-cycle payments – no date in the next calendar month

A child support payment is treated as being received on 31 August. As there is no 31 September, the "same" date would be 1 October. The rest of the rules for treating child support as income would apply as described above.

Fortnightly benefits

The period of entitlement for fortnightly benefits runs from Wednesday to Tuesday for two weeks. The benefit payment is made to the beneficiary in the second week of the fortnightly period.

When a child support payment starts to be income depends on whether the child support is treated as being received in the first week or the second week of the fortnight. A payment is treated as received on the business day after Inland Revenue notifies MSD that the payment has been made to the receiving carer.

If the payment is treated as being received in the first week of a fortnight, the payment would be treated as income from the Wednesday on or before the payment is treated as being received.

Example 6: Fortnightly benefits – receipt in the first week

	Wed	Thu	Fri	Sat	Sun	Mon	Tue
Week 1	16 Payment starts being income	17	18 Payment made and MSD notified	19	20	21 Date treated as being received	22
Week 2	23	24	25	26	27	28	29

If the payment is treated as being received in the second week of a fortnight, the payment would be treated as income from the Wednesday following the date the payment is treated as being received – that is, the beginning of the next fortnight.

Example 7: Fortnightly benefits – receipt in the second week

	Wed	Thu	Fri	Sat	Sun	Mon	Tue
Week 1	16	17	18	19	20	21	22 Payment made and MSD notified
Week 2	23 Date treated as being received	24	25	26	27	28	29
Week 1 (next pay period)	30 Payment starts being income	1	2	3	4	5	6

If a person is paid their benefit fortnightly, the child support payment is treated as income for four weeks only. The child support payment is divided by four to get the weekly income amount. Therefore, when a child support payment is made, MSD will work out when the payment will start to be income and spread the child support payment across the next two fortnightly benefits. Whether a payment is an in-cycle or out-of-cycle child support payment is not relevant when benefits are paid fortnightly.

Example 8: Fortnightly benefits

Kahla receives a fortnightly benefit. One of her benefit payments is for the fortnight from 16 August to 29 August 2023.

Inland Revenue makes a $400 child support payment to Kahla on 17 August. The payment is treated as received on the next business day – 18 August.

As the payment is treated as received in the first week of the fortnight (16 August to 22 August), the payment is income from 16 August.

The child support payment would be treated as income across two fortnight benefit periods. MSD would treat $100 as income for each week in the fortnight from 16 August to 29 August, and $100 for each week in the fortnight from 30 August to 12 September.

	Wed	Thu	Fri	Sat	Sun	Mon	Tue
Week 1	16 Payment starts being income	17 Payment made and MSD notified	18 Date treated as being received	19	20	21	22
Week 2	23	24	25	26	27	28	29
Week 1 (next fortnight)	30	31	1	2	3	4	5
Week 2 (next fortnight)	6	7	8	9	10	11	12 Payment stops being income

Transferring between different benefit frequencies

When a beneficiary transfers from a weekly benefit to a fortnightly benefit, or vice-versa, the above rules could sometimes result in their benefit being abated more than intended.

The amendments include a limited discretion that allows MSD to treat the child support payment as income over a different number of weeks. The intent is for the income to be treated as close as possible to the prescribed rules.

However, sometimes a beneficiary may transfer to a benefit with a different payment frequency part way through the period. This means a child support payment could start being income before the new benefit commences. In those circumstances, the beneficiary would not be paid the correct amount of benefit. MSD is not able to rectify the incorrect payment using the discretion outlined above.

The amendments therefore also exempt child support payments from being income for benefit and other assistances when all of the following occur:

- a beneficiary transfers from a weekly benefit to a fortnightly benefit or vice versa
- the child support payment is treated as being received on or after the day of the new benefit, and
- the child support payment is treated as income before the day of the new benefit.

However, this exemption does **not** apply to information share child support under the Public and Community Housing Management Act. MSD will continue to have discretion to assess whether information share child support is assessable income, or a cash asset, for social housing and income-related rent, as no automated charging is occurring.

Example 9: Transferring between benefits – child support exemption

Barry moves from a fortnightly benefit to a weekly benefit on Tuesday 17 October 2023.

Inland Revenue notifies MSD of a child support payment on Thursday 19 October. The payment would be treated as received on Friday 20 October.

If Barry was on a weekly benefit for the whole period, his child support income would have been treated as income from Monday 16 October. However, Barry's weekly benefit did not begin until Tuesday 17 October, which means this child support payment would be treated as income before the day the new benefit starts.

The child support payment received by Barry is exempt income and will not be income for benefit purposes.

Mon	Tue	Wed	Thu	Fri	Sat	Sun
16 Payment would normally start being income	17 **New weekly benefit begins**	18	19 Payment made and MSD notified	20 Date treated as being received	21	22

How child support payments are treated in specific situations

Temporary break in benefits

Information share child support payments will continue to be treated as income even when there is a temporary break in the receiving carer's assistance and they resume receiving an assistance in the same income-charging period (that is, in the four- or five-week period the child support is income for). This may be the resumption of the assistance they were receiving prior to the break, or they may be paid a new type of assistance.

The temporary break in the receiving carer's assistance may be for any reason, whether it is suspended, expired or cancelled.

Example 10: Temporary break in benefits

Tama receives an information share child support payment that is income over four weeks from 25 September to 22 October. On 5 October, Tama's benefit is suspended because he temporarily leaves New Zealand.

Tama returns to New Zealand on 10 October and his benefit resumes.

Tama's information share child support payment continues to be income while he is overseas, but his benefit is suspended during this time, so this income does not affect his entitlement.

Child support received during a benefit suspension or expiry

In the previous scenario, information share child support payments received before a temporary break in a person's assistance continue to be income during the temporary break to ensure the correct amount of child support is income if and when the assistance resumes.

For the same reason, information share child support payments received during a temporary break continue to be income so that the correct amount of child support is taken into account when the assistance resumes.

This will only apply when the assistance is suspended or expired. This is because a cancelled assistance is not an active record with MSD so the child support payment information provided by Inland Revenue cannot be matched to this client.

Example 11: Child support received while an assistance is suspended or expired

Tama receives Jobseeker Support. On 5 October, he temporarily leaves New Zealand and MSD suspends his benefit.

Tama receives an information share child support payment on 11 October, while his benefit is suspended. In line with the new income rules, MSD will divide this child support and allocate the payment as income across the next four weeks till 5 November.

Tama returns to New Zealand on 17 October and his Jobseeker Support resumes. Because the new income rules are applied to Tama's child support while his assistance was suspended, MSD can apply the correct amount of child support income to his assistance.

General provisions child support payments

Child support paid to UCB beneficiaries and mixed child support payments

UCB excess (the amount of child support paid to the receiving carer after the cost of their benefit has been recovered) is only income for Temporary Additional Support, Special Benefit and Childcare Assistance. This is because the cost of the UCB has been recovered by retaining child support.

A "mixed child support payment" refers to when a receiving carer is paid child support and the payment is for a child for whom UCB is paid and another child for whom UCB is not paid (and so child support is not retained). It is not possible to determine the amount of the payment that relates to each child to apply different income rules to the payment. Therefore, MSD will treat the entire child support payment as a UCB excess. This treatment is to ensure the person is not negatively impacted.

Because mixed child support payments would have only been income for some benefits, it is not appropriate to apply the new income rules.

Example 12: Child support payments for more than one child when UCB is paid for some of those children

Hayden is assessed to pay $200 a month of child support to Jess for Oliver, for whom Jess is also receiving a UCB.

Hayden is also assessed to pay Jess $200 a month of child support for Liam. Jess is not receiving UCB for Liam.

This month, Hayden only pays $280 instead of the full $400. The entire child support payment would be treated as if it were UCB excess. This means the $280 paid by Hayden would only be treated as income for determining Jess's entitlement to Temporary Additional Support, Special Benefit and Childcare Assistance.

Other general provisions child support payments

Court-ordered child support payments

Payments ordered by a Family Court and foreign child support payments will continue to be treated as income under the general income rules, which means these payments will be processed manually and MSD will have discretion over which periods to allocate these payments to.

This is because the discretionary rules are considered more appropriate for determining the relevant periods for which these payments should be treated as income.

Backdated benefit payments

An information share child support payment is excluded from being income if the beneficiary has applied for a benefit, and that benefit is backdated to an earlier date, but they were not receiving income-tested assistance from MSD at the time Inland Revenue makes the child support payment to them.

However, this exemption will **not** apply to information share child support under the Public and Community Housing Management Act 1992. MSD will continue to have discretion to assess whether information share child support is assessable income, or a cash asset, for social housing and income-related rent, because no automated charging is occurring.

Example 13: Backdated benefits

Jack receives a child support payment on 6 September 2023. He was not receiving any benefit or assistance from MSD at the time.

Jack decides to apply for financial assistance and does so on 20 September. MSD determines that Jack was entitled to Sole Parent Support from 30 August.

Although Jack received a child support payment on 6 September 2023, and his benefit commenced on 30 August, Jack received this payment before MSD's decision to grant him Sole Parent Support. This child support payment is therefore not income and does not abate his Sole Parent Support.

Child support received from 20 September will be income (unless other exemptions apply) and may abate Jack's Sole Parent Support.

Limited ability to review child support income

Sections 304, 304A and 418 of the Social Security Act 2018

MSD's power to review a past benefit period does not apply to information share child support payments unless a specified circumstance applies.

Background

MSD has broad powers that allow it to review a person's benefit entitlement. This power is necessary for MSD to ensure beneficiaries receive their full and correct entitlement.

Child support amounts assessed by Inland Revenue may change. This may be due to a change in either parent's circumstances coming to light after the fact. In such cases, MSD ordinarily uses its broad powers to review the receiving carer's benefit. However, such reviews increase income uncertainty for beneficiaries and contribute toward families incurring benefit debt.

Key features

The use of MSD's review power for child support payments is limited to specified scenarios. This ensures child support payments are almost always spread forward, which reduces the likelihood of debt, and ensures that child support payments are treated as income in a way that best reflects money that the beneficiary has available.

Example 14: Limited ability to review

Elaine was receiving child support for her two children, Chloe and Claire. When Chloe left her care, Elaine did not tell Inland Revenue immediately. When she finally told Inland Revenue, her child support was recalculated from the date Chloe left her care. Elaine now has a child support debt.

Despite Elaine's child support assessment being reduced, MSD will not go back and change the amount of child support that was previously treated as income for Elaine. This is because Elaine still received and had use of the amount of child support that was treated as income at the time.

However, if Elaine's circumstances result in her child support assessment being increased, the increased child support will only be income when it is received. MSD will not retrospectively review her benefit for periods the child support relates to.

However, there are circumstances under which MSD should be able to review child support income for a past period. Section 304A sets out the circumstances under which MSD is able to review child support income and amend the amount that was previously treated as income:

- Inland Revenue makes a payment of child support to a beneficiary, and MSD is later notified either by the beneficiary or by Inland Revenue that the beneficiary has not received the payment or not received it by the deemed receipt date.
- MSD is satisfied, in exceptional circumstances, that a person cannot access their child support payment.
- An error has occurred in the administration of how a child support payment has been treated as income. These include situations where the information shared is incorrect due to Inland Revenue error, or where the information is read incorrectly by MSD's system or was input incorrectly due to human error.

- A beneficiary has been incorrectly identified or is not identified at all as the proper recipient of the payment.
- MSD receives the information shared by Inland Revenue late, or the information is provided late.
- When a beneficiary has died and they receive a child support payment after their death, because a beneficiary's benefit entitlement cannot change after they have died. This would allow MSD to amend a beneficiary's entitlement as necessary.

Example 15: Circumstances where MSD will review

Barret receives $200 child support each month. One month, Inland Revenue makes a payment of child support to Barret's bank account. However, an issue with the bank's processes means Barret did not receive his child support.

Because Inland Revenue has notified MSD of the payment, MSD treats Barret as having received income of $50 per week for the next four weeks.

Barret notifies MSD that he has not received his child support. After confirming this, MSD can go back and remove the child support income that is on his record. Once MSD has confirmed that the payment has been processed by Barret's bank, the child support income will be added to his record from when it is processed.

New review grounds can be added via regulations if they are identified. This allows new scenarios to be reviewed in a timely manner.

Deprivation of income

Clauses 16 and 17 of schedule 3 of the Social Security Act 2018

A person choosing not to enter into a child support arrangement or to cancel an existing arrangement is not considered to be depriving themselves of income.

Background

One of the principles underlying the Social Security Act 2018 is that people should use the resources available to them before seeking financial support. When someone has changed their position to put themselves at a financial disadvantage, and this leads to them qualifying for assistance, or assistance at a higher rate, this is considered "deprivation". Deprivation can apply regardless of whether this was intentional.

When MSD is satisfied that deprivation has occurred, it may refuse to grant a benefit, cancel or reduce a benefit already granted, or grant a benefit at a reduced rate.

Key features

The requirement for parents receiving a sole parent rate of main benefit to apply for child support through Inland Revenue has been removed. Therefore, a parent newly eligible for a benefit may choose not to apply for child support. In addition, existing beneficiaries who previously had to apply for child support through Inland Revenue may choose to cancel their child support. Treating these decisions as deprivation would defeat the purpose of the proposed policies.

A person choosing not to apply for child support, or to cancel an existing child support arrangement, will not be considered to be depriving themselves of income.

This exclusion applies to all forms of child support, including private arrangements that Inland Revenue does not administer.

This change does not apply to UCB beneficiaries (see "Amendments do not apply to people receiving an Unsupported Child's Benefit" above).

Stand downs

Regulation 182 of the Social Security Regulations 2018

All child support paid to a person under the Child Support Act 1991 (excluding an amount that MSD has determined is capital) will be considered when calculating the person's stand-down period.

Background

Most main benefits are subject to an initial income stand-down period. The stand-down period is either one or two weeks after the date a person becomes entitled to the benefit. The period depends on the person's circumstances and their average income determined over an "average income calculation period".

Key features

All child support paid under the Child Support Act 1991 that a person receives over the relevant period would be included in their "average income" for calculating the stand-down period. This includes excess child support paid to an Unsupported Child's Benefit beneficiary. An amount that MSD determines is capital is excluded.

Cash asset test

Clauses 1 and 2, and Parts 35 to 37 of schedule 8 of the Social Security Act 2018 and regulation 3(1) of the Public and Community Housing Management (Prescribed Elements of Calculation Mechanism) Regulations 2018

Information share child support payments are exempted from being a cash asset for the period the payment is income for benefit purposes. After this period, any unspent child support could be included in a cash asset test.

The initial exemption period could be extended by an additional 28 days in exceptional circumstances.

Background

The Accommodation Supplement and Temporary Additional Support are subject to a cash asset test. This means that MSD considers a person's cash assets (such as savings) when working out their benefit entitlement. If a person has cash assets over a set threshold, they cannot receive these benefits. This test is to ensure that people use the resources available to them before receiving assistance. MSD's practice is generally to treat payments as a cash asset from the time they are received.

Child support payments are intended to support the child for four or five weeks after they are received. Treating child support payments as a cash asset from the time they are received is incompatible with this intent. If the cash asset tests continue to apply to child support payments, receiving carers would be penalised for spending the child support payment over the period it is intended for.

Key features

Child support payments are exempt from the cash asset test for the period the payments are income for benefit purposes. MSD also has the discretion to extend this period by an additional 28 days in exceptional circumstances. After the exemption expires, any unspent child support payment could be included in a cash asset test.

However, the cash asset exemption will not apply to information share child support under the Public and Community Housing Management Act 1992. MSD will continue to have discretion to assess whether information share child support is assessable income, or a cash asset, for social housing and income-related rent, as no automated charging is occurring.

Abatement of youth and young parent payments

Part 6 of schedule 4 of the Social Security Act 2018

The abatement regime of the youth payment (YP) and the young parent payment (YPP) have been amended so that child support passed on continues to abate those payments at the relevant rate instead of causing the recipient to lose their payment altogether.

Background

YP and YPP have an abatement regime where a person's weekly income starts to abate once it exceeds a specified threshold. Once the person's weekly income exceeds a second, higher threshold, the payments stop altogether. This is to encourage the young person to further their education or training.

With child support being passed on, a receiving carer could lose their benefit if their weekly income exceeds the second threshold.

Example 16: Abatement of YP and YPP

Rydia is receiving YPP of $440.96 a week. Her weekly income is $298.08 per week. Her YPP is abated $1 for every $1 that her weekly income exceeds $258.08 (the first threshold), meaning her YPP is abated by $40. This reduces her YPP to $400.96 per week.

Rydia starts receiving child support of $20 per week, therefore her weekly income increases to $318.08. Under previous rules, she would no longer be eligible for YPP as her weekly income now exceeds $308.08 (the second threshold).

Key features

A person no longer loses their YP or YPP immediately if their weekly income exceeds the second threshold because of a child support payment passed on by Inland Revenue. Rather, the child support income would continue to abate their benefit at the rate of $1 for every $1 for single persons, and $0.50 for every $1 for couples.

If a person's income from all other sources exceeds the second threshold, they lose their YP or YPP. To achieve this result, income from employment and other sources is considered against the thresholds before any abatement for child support payments passed on by Inland Revenue is undertaken.

Example 17: Proposed YP/YPP abatement rules for child support payments

Kain has $298.08 weekly income and receives an abated YPP of $400.96 per week.

Kain starts receiving child support of $20 per week and his weekly income increases to $318.08. Kain would have his YPP abated by a further $20 to $380.96 per week instead of losing his YPP altogether.

However, the abatement rules only apply to child support payments passed on by Inland Revenue. Therefore, if Kain's weekly income excluding any child support payments (for example, wages) exceeded $308.08, he would lose his eligibility for YPP.

Child support as an allowable cost

Schedule 1 of the Social Security Act 2018 and regulation 71 of the Social Security Regulations 2018

Child support liabilities assessed by Inland Revenue are an "allowable cost" for determining a liable parent's Temporary Additional Support (TAS). This amendment also extends to Special Benefit (SpB) through an amendment made to the Ministerial Direction.

People already receiving TAS and SpB on 1 July 2023 can have these costs backdated (taken into account) to the later of 1 July or the date they become liable for child support. They must apply on or before 29 September 2023 to have the costs backdated.

Background

TAS and SpB are forms of hardship assistance paid to people who do not have enough income to meet their "essential costs". Essential costs are made up of a person's "allowable costs" and "standard costs". Allowable costs are regular, essential, and unavoidable expenses that cannot be reduced.

Key features

MSD will consider formula-assessed child support liability as an allowable cost when determining a liable parent's entitlement to TAS or SpB. This does not extend to voluntary agreements or private arrangements of child support because they do not meet MSD's standard of regular, essential and unavoidable expenses.

Backdating

Allowable costs usually cannot be backdated. However, to support MSD with the expected increase in contacts from TAS and SpB recipients, MSD is temporarily allowed to backdate formula-assessed child support liabilities as an allowable cost.

Backdating is available for clients who are already receiving TAS or SpB on 1 July 2023 and allows their child support liability to be backdated as an allowable cost to either 1 July 2023 or the date on which they become liable to pay child support – whichever is later. However, these beneficiaries will need to apply to MSD on or before 29 September 2023.

Amendments to the Public and Community Housing Management Act 1992

Child support payments treated as income: housing and income-related rent

Section 2 and 115A of the Public and Community Housing Management Act 1992 and regulation 14 of the Public and Community Housing Management (Prescribed Elements of Calculation Mechanism) Regulations 2018

Prescribed types of child support payments are excluded as income when determining a person's eligibility for public housing, rating on the Public Housing Register, and for determining the rate of income-related rent payable.

Background

For public housing (eligibility, rating on the Public Housing Register and rates of income-related rent), child support payments are treated as income, similar to main benefits and assistance under the Social Security Act 2018.

Key features

Prescribed types of child support payments are excluded as income when determining a person's eligibility for public housing, rating on the Public Housing Register, and for determining the rate of income-related rent payable.

The same child support payment types that are excluded as income for main benefits under the Social Security Act 2018 are also excluded as income when determining a person's eligibility for public housing, rating on the Public Housing Register and the rate of income-related rent payable.

When Inland Revenue shares child support payment information with MSD, a person's duty to declare a change in their circumstances is satisfied unless the information is incorrect.

Deprivation of income: income-related rent

Section 112 of the Public and Community Housing Management Act 1992

A person choosing not to enter into a child support arrangement or to cancel an existing arrangement is not considered to be depriving themselves of income.

Background

When someone has changed their financial arrangements to put themselves at a financial disadvantage, and this leads to them paying a lower rate of income-related rent than they otherwise would, this is considered "deprivation of income". This can apply regardless of whether the change in their position was intentional.

In these situations, MSD is authorised to include all or a portion of the deprived income when determining the rate of income-related rent payable. This is to reflect the income that would have been assessed had the person not deprived themselves of income.

Key features

Parents newly eligible for a benefit can choose not to apply for child support. In addition, existing beneficiaries who previously had to apply for child support through Inland Revenue can choose to cancel their child support. Treating these decisions as deprivation would defeat the purpose of removing the requirement for sole parents to apply for child support (see "Deprivation of income" above).

This exclusion applies to all forms of child support, including private arrangements that Inland Revenue does not administer.

A person's duty to advise of a change in circumstances

Section 115A of the Public and Community Housing Management Act 1992

A person's duty to declare a change in circumstances is satisfied if a child support payment made to the person is disclosed to MSD by Inland Revenue under their approved information sharing agreement.

Background

Under the Public and Community Housing Management Act 1992, a person is required to promptly advise MSD of any change in household circumstances that is likely to result in:

- the payment of a higher income-related rent
- no longer needing, or being eligible for, public housing.

This ensures a person's income-related rent, eligibility for public housing and priority rating on the Public Housing Register is reflective of their circumstances and current income.

Key features

A person's duty to declare a change in circumstances (such as an increase in their child support income) is satisfied if that change is already being communicated to MSD by Inland Revenue. This prevents a person being at risk of benefit debt if they had not declared their changes (despite the information sharing between MSD and Inland Revenue).

There may be rare circumstances where the payment details in the information share are incorrect, and the person will need to advise MSD of the error. The person's obligation to declare a change in circumstances remains if:

- MSD is notified of the change via the information share, and
- MSD notifies the person of the information share child support payment, and
- the person considers the information share is incorrect and does not promptly dispute the correctness of the information.

This avoids MSD referring to an incorrect amount of child support when determining a person's rate of income-related rent, eligibility for public housing or their rating on the Public Housing Register.

Redundant provisions

Schedule 2 of the Public and Community Housing Management Act 1992
Schedule 2 of the Public and Community Housing Management Act 1992 is repealed.

Background

Schedule 2 of the Public and Community Housing Management Act 1992 was a transitional arrangement that was replaced by regulations in the Public and Community Housing Management (Prescribed Elements of Calculation Mechanism) Regulations 2018 and is no longer operative. The schedule has been repealed.

BINDING RULINGS

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

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

BR PUB 23/08: Goods and Services Tax – Payments made by parents to state and state integrated schools

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

Taxation law | Ture tāke

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

This Ruling applies in respect of ss 8 and 10(2) and the definition of "consideration" in s 2.

The arrangement to which this Ruling applies | Te whakaritenga i pāngia e tēnei Whakataunga

The Arrangement is:

- the payment of amounts (whether described as "school fees", "donations", "voluntary contributions", "activity fees" or otherwise);
- to the school board of a state school or state integrated school that has not opted or are ineligible to opt into the school donations scheme under s 551 of the Education and Training Act 2020;
- by parents or guardians of domestic students enrolled at such a school.

In this Ruling the terms "domestic student", "state school" and "state integrated school" are given the same meaning as in s 10 of the Education and Training Act 2020.

How the taxation law applies to the Arrangement | Ko te pānga o te ture tāke ki te Whakaritenga

The taxation law applies to the Arrangement as follows:

- GST is not chargeable on payments made to the school board of a state or state integrated school by parents or guardians of domestic students enrolled at such a school, where the payments are made to assist the school with the cost of delivering the education that the student has a statutory entitlement to receive free of charge.
- GST is chargeable on payments made for supplies of other goods or services, not integral to the supply of education to which the student has a statutory entitlement to receive free of charge, where those supplies are conditional on the payments being made.

The period for which this Ruling applies | Ko te wā i pāngia e tēnei Whakataunga

This Ruling will apply for an indefinite period beginning on 21 June 2023.

This Ruling is signed by me on 12 June 2023.

Tania Sauvao

Tax Counsel Lead, Tax Counsel Office |
Rōia Kaihautū Taake, Te Tari Tohutohu Tāke

Commentary on Public Ruling | Takinga kōrero o ngā Whakatau Tūmatanui BR Pub 23/08

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 23/08 ("the Ruling").

Summary | Whakarāpopoto

1. In accordance with Ministry of Education guidance, school boards of state and state integrated schools are permitted to ask parents or caregivers for voluntary contributions, including contributions towards the cost of delivering the school's curriculum. In addition, schools may offer for sale consumables, stationery, clothing and optional activities that do not form part of the delivery of the school's curriculum. Schools are permitted to charge for these additional things, but students are not obliged to buy them.
2. This Ruling addresses whether payments (however described) made by parents to state and state integrated schools are subject to GST. In this Commentary the word "parents" includes guardians or caregivers of students who also make payments to state or state integrated schools.

Background | Horopaki

Application of this Ruling

3. This Ruling applies indefinitely from 21 June 2023.
4. The subject matter covered in this Ruling has previously been addressed in:
   - Public Ruling BR Pub 18/06: Goods and Services Tax - Payments made by parents to state and state integrated schools, *Tax Information Bulletin* Vol 30, No 7 (August 2018): 3 (expiring on 20 June 2023);
   - Public Ruling BR Pub 14/06: Payments made by parents or guardians of students to state schools – GST treatment, *Tax Information Bulletin* Vol 26, No 9 (October 2014): 3 (expired);
   - Public Ruling BR Pub 09/01: Payments made by parents or guardians of students to state schools – GST treatment, *Tax Information Bulletin* Vol 21, No 3 (May 2009): 4 (expired); and
   - Public Ruling BR Pub 03/04, *Tax Information Bulletin* Vol 15, No 7 (July 2003): 6 (expired).

Ministry of Education guidance in Circular 2021/03

5. The Ministry of Education provides guidance to school boards, proprietors of state integrated schools, principals, parents and students in relation to requests for donations and other forms of payments to schools and kura. This guidance is provided in *Circular 2021/03: Payments by parents of students in schools.*[1] The circular explains the types of payments school boards and proprietors may request from parents and students.
6. Circular 2021/03 updates the previous circular on payments by parents (Circular 2018/01[2]) to reflect references to the new Education and Training Act 2020 (EATA 2020) and to include guidance on the school donations scheme in s 551 of the EATA 2020 (the Donations Scheme). The advice in this Commentary is intended for parents with children enrolled at schools that have not opted or are ineligible to opt into the Donations Scheme.
7. The circular confirms that no payments sought by school boards and proprietors from parents are compulsory except for the attendance dues payable to the proprietors of state integrated schools and charges by schools for voluntary purchases of goods and services where parents have agreed to the purchase. The circular also confirms that when referring to donations, schools must not use the words "fee", "levy", or "charge", or any other term which implies that payment is compulsory. Schools can only charge for goods or services where they relate to items or activities outside of the curriculum. Parents must not be placed under an expectation or obligation to purchase goods or services.

1 *Circular 2021/03: Payments by parents of students in schools* (Ministry of Education, 2021).
2 *Circular 2018/01: Payments by parents of students in schools* (Ministry of Education, 2018).

Education framework

School governance

8. Every state and state integrated school must have a school board.[3] A board is responsible for the governance of its school.[4] A board's primary objectives in governing a school are set out in s 127(1) of the EATA 2020 and include ensuring that every student at the school is able to attain their highest possible standard in educational achievement. Section 127(2) specifies what a board must do to meet those objectives. This includes having regard to any statement of national education and learning priorities and giving effect to its obligations in relation to any foundation curriculum statements, national curriculum statements, and national performance measures. A board has complete discretion to perform its functions and exercise its powers as it thinks fit, subject to the EATA 2020 and any other enactment and the general law of New Zealand.[5] Grants are paid out of public money to boards for the purpose of administering their schools.[6]
9. State integrated schools are privately owned schools established to provide education with a special character that have become part of the state system of education. When a private school is integrated into the state system it must be controlled and managed and operate in all respects as if it were a state school.[7] Therefore, as with other state schools, a state integrated school's governing body is its school board. State integrated schools also have a proprietor, who looks after the school's land and buildings and determines and supervises the school's special character.

Free education

10. Everyone who is a domestic student (that is, generally, a New Zealand citizen or resident) is entitled to free enrolment and free education at any state school during the period beginning on their fifth birthday and ending on 1 January after their 19th birthday.[8]
11. Students enrolled at any state integrated school must be given free education on the same terms and conditions as students enrolled at other state schools: cl 25 of schedule 6 to the EATA 2020. However, the proprietor of a state integrated school may require payment of attendance dues as a condition of enrolment and attendance.[9] The money received from attendance dues may be used only for improvements to the school buildings and associated facilities as required by any integration agreement, for capital works required by the Minister of Education under cl 39(2)(d) of schedule 6 to the EATA 2020, and for meeting debts, mortgages, liens or other charges relating to the school premises. Attendance dues paid to the proprietors of state integrated schools are subject to GST, being payments to secure the enrolment of a student in a school for which the proprietors provide the buildings and ensure the special character: *Turakina Maori Girls College Board of Trustees v CIR*.[10]
12. Each year, parents of students enrolled at state and state integrated schools may be asked by their school's board to pay nominated amounts to assist the school with its costs, including the cost of delivering its curriculum. Schools may refer to these payments as "donations", "voluntary contributions" or the like. In the case of state integrated schools, such payments are in addition to attendance dues payable to the proprietor.

Application of the legislation | Whakapānga o te whakature

Scheme of the Goods and Services Tax Act 1985

13. GST is chargeable on a supply of goods and services by a registered person in the course or furtherance of a taxable activity carried on by that person by reference to the **value** of the supply.[11] The value of the supply (plus the GST charged) equals the **consideration** provided for the supply (including both monetary and non-monetary consideration).[12]

3 Section 118 of the Education and Training Act 2020 (EATA 2020).
4 Section 125 of the EATA 2020.
5 Section 131 of the EATA 2020.
6 Section 550 of the EATA 2020.
7 Clause 24 of schedule 6 to the EATA 2020.
8 Section 33 of the EATA 2020.
9 Clause 30 of schedule 6 to the EATA 2020.
10 *Turakina Maori Girls College Board of Trustees v CIR* (1993) 15 NZTC 10,032 (CA).
11 Section 8(1) of the Goods and Services Tax Act 1985 (GSTA 1985).
12 Section 10(2) of the GSTA 1985.

14. GST is chargeable on payments made to the school board of a state school that is a registered person if such payments are "consideration", as defined in the Act. Any charitable trusts or parent–teacher associations for the same school should be considered separately when determining the school's GST registration. Generally, the board of a state or state integrated school will be a registered person because the activities of a school board are taxable activities for GST purposes. This is on the basis that every school board of a state or state integrated school is a Crown entity for the purposes of the Crown Entities Act 2004.[13] A Crown entity is a "public authority"[14] and, pursuant to s 6(1)(b), the term "taxable activity" includes the activities of any public authority. Section 5(6) deems that a school board (as a public authority) is supplying goods and services where it receives revenue from the Crown for the supply of outputs (in this case, the supply of education services). For example, a school board is deemed to be making a GST supply when it receives operational funding from the Crown for the supply of education services. The operational funding is the consideration for that supply.
15. GST is chargeable on that supply by the school board of a state or state integrated school by reference to the "consideration" provided for the supply.[15]

Definition of "consideration" for GST purposes

16. The statutory definition of "consideration" in the Act is wider than the contract law meaning of the term. In *Trustee, Executors and Agency Co NZ Ltd v CIR*[16], Chisholm J commented in respect of the definition of "consideration" (at 13,085):

> In the context of this matter I am not persuaded that it is helpful or appropriate to reflect upon the ordinary meaning of the word. The statutory definition extends the ordinary meaning and it is the scope of the extended statutory definition which needs to be determined.

17. The following seven principles are drawn from the cases on the definition of "consideration" in the Act.

Whether the payment is voluntary is irrelevant

18. Under the first part of the definition of "consideration", it is irrelevant whether the payment is voluntary. No contract between the person making the supply and the person providing the consideration is necessary. The supply need not be made to the person who makes the payment: *Turakina*. In *Turakina*, McKay J, referring to the definition, said (at 10,036):

> It is clear from this definition that the supply of any service for consideration is part of a "taxable activity" under sec 6, even though it is to a person other than the person who provides the consideration. Likewise, the value of the supply is to be measured by the consideration, whether or not the consideration is provided by the person to whom the service is supplied. It is not necessary that there should be a contract between the supplier and the person providing the consideration, so long as the consideration is "in respect of, in response to or for the inducement of the supply.

Supply need not be made by the person who receives the payment

19. The supply also need not be made by the person who receives the payment. In *Trustee, Executors and Agency Co*, Chisholm J said (at 13,086):

> in my opinion the crucial factor is the strength of the connection between the payment and the supply. If there is sufficient proximity between the supply and payment to satisfy the requirement that the payment is "in respect of" (or "in response to, or for the inducement of") the supply of goods then the payment qualifies as "consideration" notwithstanding that the payment is made to a third party.

Not every payment received is "consideration"

20. Although the statutory definition of "consideration" is wider than the contract law meaning, not every payment a registered person receives is "consideration" for GST purposes. A distinction is drawn between a payment in respect of the payee's taxable activity and a payment that is consideration for a supply of goods and services: *Director-General of Social Welfare v De Morgan.*[17]

13 Section 7(1)(d) of the Crown Entities Act 2004.
14 "Public authority" is defined in s 2 of the GSTA 1985.
15 Section 8 of the GSTA 1985.
16 *Trustee, Executors and Agency Co NZ Ltd v CIR* (1997) 18 NZTC 13,076 (HC).
17 *Director-General of Social Welfare v De Morgan* (1996) 17 NZTC 12,636 (CA).

Payment and the supply must be connected

21. For a payment to be "consideration" within the first part of the definition, a sufficient relationship must exist between the making of the payment and the supply of goods or services: *CIR v NZ Refining Co Ltd*[18]; *Chatham Islands Enterprise Trust v CIR*[19]; *Taupo Ika Nui Body Corporate v CIR*[20]; *Trustee, Executors and Agency Co; Rotorua Regional Airport Ltd v CIR*[21].

22. In *NZ Refining*, Blanchard J said (at 13,193):

> It is fundamental to the GST Act that the tax is levied on or in respect of supplies. It is not a tax on receipts or on turnover; it is a tax on transactions … It is therefore necessary, as Mr Green submitted, to distinguish between supplies and the taxable activity (as defined in s 6) in the course of which they are made. The definition in s 6 itself requires a nexus between a supply and consideration, as does s 10.
>
> The tax itself is levied by s 8 on a supply in the course or furtherance of a taxable activity and is "by reference to the value of that supply". Section 10 provides that the value of a supply is "to the extent of the consideration for the supply" the amount of the money involved or the non-monetary open market value of the consideration. Already, before turning to the definition of "consideration", it can be seen that, again, a linkage between supply and consideration is requisite to the imposition of the tax.
>
> **The definition of "consideration", though broad, cannot and does not dispense with that requirement. To constitute consideration for supply a payment must be made for that supply, though it need not be made to the supplier nor does the supply have to be made to the payer.**
>
> **There is a practical necessity for a sufficient connection between the payment and the supply.** The mechanics of the legislation will otherwise make it impossible to collect the GST. [Emphasis added]

Expectation of a supply of goods and services is not enough

23. An expectation that the payee will supply goods and services is not enough. It is not sufficient that the person who receives the payment carries out some activity that has the effect of benefiting either the person making the payment or some other person.

24. It is also not sufficient that the payment enables the payee to carry on its activity. Hence, a payment by the Crown to a charitable trust the Crown had established to promote the economic development and well-being of the Chatham Islands' inhabitants and the provision of services in the interests of the community was not consideration for GST purposes. The trustees were fulfilling their fiduciary duties under the trust, and the payment was not an inducement for the performance of services by the trustees: *Chatham Islands*.

Element of reciprocity must exist

25. The expression "in respect of, in response to, or for the inducement of" in the definition of "consideration" involves an element of reciprocity: *Taupo Ika Nui*; *Chatham Islands*; *Rotorua Regional Airport*.

Consider the legal arrangements between the parties

26. It is necessary to consider the legal arrangements between the parties to determine whether a payment is consideration. In *Chatham Islands*, Blanchard J commented (at [17]):

> Although the linkage or nexus between a payment and the activity to which it gives rise may be very broad, it is still necessary to have regard to the legal form which is being employed:
>
> > … in taxation disputes the Court is concerned with the legal arrangements actually entered into … not with the economic or other consequences of the arrangements.
>
> (*C of IR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 at p 13,192 citing *Marac Life Assurance Ltd v C of IR* [1986] 1 NZLR 694 at p 706. The tax being one on transactions, it is necessary to pay close attention to the legal nature of what has been done.

18 *CIR v NZ Refining Co Ltd* (1997) 18 NZTC 13,187 (CA).

19 *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075 (CA).

20 *Taupo Ika Nui Body Corporate v CIR* (1997) 18 NZTC 13,147 (HC).

21 *Rotorua Regional Airport Ltd v CIR* (2010) 24 NZTC 23,979 (HC).

Role and accountability of school boards

27. In *Maddever v Umawera School Board*[22], Williams J discussed the role of school boards (at 505):

> The [Education Act 1989] was based on *Administering for Excellence: The Report of the Task Force to Review Education Administration* (the Picot report (1988)) which found that the existing administrative structure of the Education Act 1964 was over-centralised and overly complex. Its recommendations for change were largely implemented in the Education Act 1989, the title of which states that it is "An Act to reform the administration of education". The statute brought about a marked devolution of decision making away from the Minister of Education and the Department of Education so that schools became the basic unit of education administration. The primary mechanisms in the statute to achieve the legislative objectives were the novel concept of boards of Trustees who were given by s 75 broad powers to manage schools and the idea of the school charter.

28. Williams J noted that the accountability of school boards was achieved in several ways, including the requirement for boards to have a charter and adhere to it. He referred to the requirements relating to charters in s 61 of the Education Act 1989 and went on to say (at 505):

> It is thus clear that the [Education Act 1989] contemplates that the board, in consultation with the Minister, should have a significant role in determining the school's educational goals and a degree of independence in deciding how those goals should be achieved. While the Ministry of Education influences a school's broad objectives through the application of the national educational guidelines established under s 60A … and the Minister also has a power of approval of school charters, the guidance thus provided is in rather general terms. It is for the parents, staff and other persons to largely determine the distinctive character of the charter for a particular school.

29. Under the EATA 2020 school charters are being replaced by a requirement for boards to have a strategic plan (usually for three years) for achieving its objectives and an annual implementation plan setting out how the board intends to implement that strategy during the year.[23] The strategic plan must be consulted on within the wider school community and must comply with any regulations relating to its development. The Secretary for Education may review the plan and may require changes to be made. The board must monitor, evaluate and report on its performance in achieving its objectives and implementing its strategy.[24]

30. Therefore, the policy of the education legislation has been and continues to be to decentralise the administration of education so school boards are responsible for controlling and managing the schools. Although school boards have considerable power to manage schools, such powers are subject to any enactment and the law of New Zealand.[25] The EATA 2020 provides for several ways to achieve accountability by boards, including the requirement to set a strategic plan and then monitor, evaluate and report on its performance in achieving its objectives and implementing its strategy.

Scope of free education

31. A student's statutory entitlement to free education is established in s 33 of the EATA 2020:

> 33 Right to free primary and secondary education
>
> (1) Except as provided in this Part, every domestic student is entitled to free enrolment and free education at any State school during the period beginning on the student's fifth birthday and ending on 1 January after the student's 19th birthday.
>
> (2) This right includes the entitlement to attend the school at which the student is enrolled during all the hours that the school is open for instruction.

32. It is possible to define the limits of the obligation of school boards to provide education services (and, therefore, the scope of a student's entitlement to free education). The Ministry of Education specifies through its statements of national education and learning priorities (see s 5 of the EATA 2020) and its foundation curriculum policy statements, national curriculum statements, and national performance measures, in broad terms, the type, level, and standard of instruction or education to be provided in state schools.

33. Every school board has a significant role (through the preparation of its strategic plan) in determining the school's objectives and how these are to be achieved. In effect, a school's strategic plan is an undertaking by the board to the Minister of Education that it will take all reasonable steps to ensure the school is managed, organised and administered for the purposes set out in the plan. The plan is intended to ensure the school and its students and community achieve its objectives and those specified in any statement of national education and learning priorities and in s 127 of the EATA 2020.

22 *Maddever v Umawera School Board* [1993] 2 NZLR 478 (HC).

23 Section 138 of the EATA 2020.

24 Section 145 of the EATA 2020.

25 Section 131 of the EATA 2020.

34. In setting their strategic plans school boards are under an obligation to provide education that complies with the requirements of the EATA 2020. Domestic students have a statutory right to free enrolment and free education at any state school: s 33 of the EATA 2020. The provision of free education in state and state integrated schools is supported by a grant from the Crown.[26]

Ministry of Education Circular 2021/03

35. The Ministry of Education provides advice on the rights of parents, students, school boards and proprietors about requests for donations and other forms of payment in schools. That advice is in *Circular 2021/03* and includes an appendix with further information. It updates previous *Circular 2018/01*.

36. Further information is provided on the Ministry of Education's website[27] for parents to understand what payments they can or cannot be asked for as either a donation or payment. There is also a comprehensive list of examples of payments for schools that are ineligible, or choose not, to opt into the Donations Scheme.[28]

Payments sought from parents are not compulsory except for attendance dues and charges for voluntary purchases

37. Payments sought from parents are not compulsory except for the attendance dues payable to the proprietors of integrated schools. Charges by schools for voluntary purchases of goods and services can be enforced, but only if the parent has agreed to make the purchase.

38. When communicating with parents, school boards must clearly distinguish between requests for donations and for charges. The appendix to the circular states:

> **Invoices**
>
> Requests for payment must make a clear distinction between attendance dues, charges, and donations - and between school boards and proprietors' items.
>
> Ideally, invoices should specify attendance dues (for state-integrated schools) and charges for agreed optional goods or services only. Strictly speaking, schools cannot "invoice" donations, as non-payment of donations does not give rise to a debt that is owed. On the other hand, it can make practical sense to list all requests for payments in a single document. In such cases, it must be made very clear which payments are voluntary and which are not.
>
> It is misleading to include a donation within a total which is described as 'Balance Due', or as being owed by a family.
>
> As charges for curriculum items are unlawful, they should not appear on an invoice.

Charges may not be imposed for materials used in delivering the curriculum

39. Charges may not be imposed for materials used in delivering the curriculum such as for using photocopiers, musical instruments or computer facilities. The most a school board can do if it is not in the Donations Scheme is ask for a donation in the same way as it asks for a general donation. This is because the statutory right to free education implies there should be no charge for materials or equipment used in the delivery of the curriculum.

40. However, students may be charged for the hire of musical instruments owned by the school and used outside the delivery of the music curriculum. A charge may be made for costs involved in project work (such as the production of a T-shirt in a design class) but only if the student agrees to take ownership of the finished product. Schools cannot insist that students take finished products home.

26 Section 550 of the EATA 2020.

27 See education.govt.nz/school/funding-and-financials/fees-charges-and-donations/ (accessed 8 March 2023).

28 See education.govt.nz/school/funding-and-financials/fees-charges-and-donations/examples-for-schoolskura-with-an-eqi-of-431-and-below-and-schoolskura-ineligible-or-not-opting-in-to-the-donations-scheme/ (accessed 8 March 2023).

Charges may not be imposed for attendance at a school camp as part of the curriculum

41. Charges may not be imposed for a student's attendance at a school camp that is part of the school's curriculum, including part of the content of a particular course at the school. The Ministry of Education considers it is reasonable for parents to be asked to contribute towards the cost of food and the cost of travelling. Such a request for a contribution is a request for a donation. Students may not be excluded from attending a camp that is part of curriculum delivery.
42. If students are given the choice of participating in a school camp that does not form part of the delivery of the curriculum, the school may impose a charge.

Students may not be excluded from attending a camp that is part of the curriculum because they cannot or will not pay a donation towards the cost

43. Students may not be excluded from attending a camp or going on a trip that is part of curriculum delivery (for example, field work in geography, biology and outdoor education programmes) because of an inability or unwillingness to pay a donation towards the activity's cost. It is reasonable for parents to be asked to contribute towards the cost of food and towards the costs which are involved in travel. Such a request for a contribution is a request for a donation.

Boards cannot require students to purchase a workbook that accompanies a course

44. Boards cannot require a student to purchase a workbook that accompanies a course and in which answers are written. School boards may sell workbooks, but purchase cannot be compelled.
45. Once a parent has opted to purchase the workbook, the cost becomes an enforceable charge. The circular states that if a workbook is made compulsory then a school board may ask for only a donation towards the costs.

Charges may not be imposed for some special curriculum programmes

46. Charges may not be imposed for curriculum programmes such as Reading Recovery, English for Speakers of Other Languages, special education services (speech therapy, behaviour or learning difficulties) or music tuition from Itinerant Teachers of Music.

Charges may not be imposed where tertiary-level courses are purchased as part of a secondary school programme

47. Charges may not be imposed where secondary schools purchase tertiary-level courses that they offer to senior students as part of the school programme. However, where the school merely facilitates a student's enrolment in a tertiary course, meaning the student would be enrolled only part time at the school, the student is required to pay the fees associated with the tertiary course.

Charges may be imposed for in-school activities at which attendance is voluntary

48. A charge may be imposed for in-school activities at which attendance is voluntary and conditional on payment being made such as performances by visiting drama groups, lunchtime sport or education outside the classroom opportunities.

Boards may not withhold items such as leaving certificates to motivate parents to pay school donations

49. Boards must report on student progress and are subject to the Official Information Act 1982 and Privacy Act 2020. Therefore, boards are not entitled to withhold items such as students' reports or leaving certificates to encourage parents to pay school donations or resolve unpaid debts for goods or services the school has provided.

Commissioner accepts the views in Circular 2021/03

50. The Commissioner accepts the Ministry of Education's views as expressed in Circular 2021/03. The supply of services that are necessary to the supply of education services (in which a school board has an obligation to provide instruction and in which participation by students is compulsory) is within the scope of education services to which there is a statutory entitlement to receive free of charge.
51. Services that are necessary to the supply of education services include the:
    - use of materials or goods necessary for delivering the curriculum (for example, the use of computers, of photocopiers for copying materials used in delivering the curriculum, and for materials for practical subjects);
    - the right to participate in activities that are a compulsory part of the curriculum (for example, camps that are part of the curriculum or fieldwork in geography or biology); and
    - the provision of programmes such as Reading Recovery, English for Speakers of Other Languages and special education services (for speech therapy or behavioural or learning difficulties).

52. A distinction exists between the supplies described above and supplies made in circumstances where the supply made is not necessary to the supply of education services, and students or their parents have a choice as to whether to receive the supply. Such supplies include:
    - goods supplied with a clear take-home component (such as stationery or materials) where a student is entitled to ownership of a finished product from practical classes, although a school may not insist that the student take ownership of such products; and
    - attendance at or participation in extra-curricular activities that are optional.

Supply of education services

53. Where a school board brings to charge as revenue amounts received from the Crown, such as operational grants for the supply of education services, the delivery of outputs by the grant recipient is deemed to be a supply for GST purposes: s 5(6). This means payments the Crown makes, such as operational grants, are consideration, being payments made for a school's supply of education services to students.
54. The Crown's grant is provided for the supply of education services in terms of the undertaking given by the board to the Minister of Education. A supply may be taxed only once, although GST may be chargeable on any separate supplies the board makes to parents: *Case R34*[29]; *Suzuki NZ Ltd v CIR*[30].
55. In *Suzuki*, the taxpayer was obligated to repair defective vehicles under a warranty the taxpayer gave to its customers. In turn, the taxpayer had a warranty from its parent company (from which the taxpayer had purchased the vehicles) and had received payments from the parent company for carrying out the obligations of the parent company under the parent company's warranty. There were two separate supplies: the supply of repair services under the warranty to customers and the supply of repair services to satisfy the obligations of the parent company under its warranty. As two separate supplies were made, the Court of Appeal did not accept that the Commissioner had sought to impose tax on the same supply (at [24]).
56. The Court of Appeal said at [23]:

    > This is simply an instance of the common enough situation in which performance obligations under two separate contracts with different counter-parties overlap, so that performance of an obligation under one contract also happens to perform an obligation under another. In such case a supply can simultaneously occur for GST purposes under both contracts. There is a nexus in both cases between the performance and the consideration given by the other party.

57. *Suzuki* clarifies that sometimes simultaneous GST supplies might arise under arrangements with different parties, but for GST to be chargeable on those supplies a sufficient relationship must exist between each supply and the consideration given in return for that supply.

Link between payment and supply where a statutory right exists

58. In some circumstances an existing statutory obligation may mean the relationship between the payment and a supply is insufficient. Two GST cases have addressed the situation where the parties had statutory rights or obligations outside any contractual relationship that might have existed between the parties: *Television NZ Ltd v CIR*[31]; *Case U1*[32].
59. *Television NZ* concerned payments the Department of Māori Affairs made to the Broadcasting Council (the assets and liabilities of which were later vested in Television New Zealand). The payments were for a training scheme operated by the Broadcasting Council (and later Television New Zealand) for Māori trainees. Television New Zealand argued that a supply had not been made for the payment because, in collaborating with the Department of Māori Affairs, the Broadcasting Council was merely discharging a statutory obligation to be a good employer. Being a good employer included operating a personnel policy that complied with the principle of being a good employer, including recognising the aims and aspirations of Māori, the employment requirements of Māori, and the need for greater involvement of Māori as employees of the Broadcasting Council.
60. Tompkins J held that the Broadcasting Council had made a supply of services, being the provision of the training programme. A contractual obligation existed to provide the services, and the fact the supply was in accordance with the statutory obligations of the Broadcasting Council did not affect the conclusion that a supply was made under the contract.

29 *Case R34* (1994) 16 NZTC 6,190 (TRA).
30 *Suzuki NZ Ltd v CIR* (2001) 20 NZTC 17,096 (CA).
31 *Television NZ Ltd v CIR* (1994) 16 NZTC 11,295 (HC).
32 *Case U1* (1999) 19 NZTC 9,001 (TRA).

61. Under contract law, the performance of a statutory duty is not consideration, although the undertaking of something more than the bare discharge of the duty can be good consideration: *Ward v Byham*[33]; *Williams v Williams*[34]. The *Television NZ* case is consistent with that principle. Reciprocity existed between the Broadcasting Council and the Department of Māori Affairs. Payment would not have been made if the services had not been provided. The Broadcasting Council had discretion about how it would carry out its statutory obligation to be a good employer. The provision of training services under the agreement with the Department of Māori Affairs was in accordance with the Broadcasting Council's statutory obligations, but there was no direct and specific statutory obligation to provide the training.

62. In *Case U1*, the taxpayer had granted a lease under which the tenant had an obligation to pay rates (in addition to rental). The tenant was an "occupier" under the Rating Powers Act 1988 (being the lessee of a property under a lease for a term of not less than 12 months). Under the Rating Powers Act 1988, the occupier had primary liability to pay rates. The issue in *Case U1* was whether the payment of rates formed part of the consideration for the lease. (Hence, the issue considered in *Case U1* is slightly different from that considered in the *Television NZ* case.)

63. Judge Barber considered and rejected the argument that the payment of rates was consideration (because the obligation contained in the lease to pay rates was "in respect of" the lease). He also rejected the argument that the payment of rates by the lessee was part of the inducement to persuade the landlord to lease the farm at the rental figure agreed on and was part of the lessee's response to the granting of the lease. Judge Barber considered that the lease merely recorded the legal position and was not consideration, because the payment of rates by the lessee satisfied the lessee's own statutory obligation rather than an obligation of the lessor. (However, the payment of rates by a lessee under a lease would be part of the consideration for the lease, if the lessor were primarily liable for the payment of rates, and the lessee had accepted an obligation under the lease to meet the lessor's liability.)

64. In *Television NZ*, the statutory obligation was expressed in general terms. However, in *Case U1*, the lessee had a specific statutory obligation to pay rates.

Payments by parents and the statutory right to free education

65. Payments made by parents may supplement the Crown grant to the school. School boards have a considerable degree of autonomy as to how their funds are used. How the amounts paid are used is not the test of whether a supply is made for the payment: *Chatham Islands*.

66. *Turakina* also confirms that how payments are used does not determine the nature of the supply for the payments. In *Turakina*, the court (at 10,037) rejected the taxpayers' argument that because attendance dues were applied to meet mortgage obligations of the proprietors of the schools, the attendance dues were paid for exempt supplies (being the payment or collection of any amount of interest, principal or any other amount in respect of a debt security in terms of ss 14(1)(a) (previously ss 14(a)) and 3(1)(ka)).

67. An expectation exists that amounts paid by parents will be used for the purposes of the school. However, the Commissioner considers that, because the supply of education services is not conditional on payment being made by parents and because domestic students have a statutory right to receive education services in a state or state integrated school free of charge, the relationship is insufficient between the payments made by parents and the supply of education services to which a statutory entitlement exists. In addition, the Commissioner considers that when the payments made by parents are not made for any particular purpose and the school boards do not undertake any obligations in return for payment, this more strongly supports the conclusion that a sufficient relationship does not exist between the payment and any other supply: *Chatham Islands*.

68. Some school boards may attempt to collect amounts unpaid by withholding items (for example, school reports, leaving certificates or school magazines) until payment is made. It is possible to argue that, although school boards have an obligation to the Minister of Education to supply education services, if a threat is made to withhold education services unless payment is made, a separate obligation exists to parents to supply education services under a separate transaction with the parents. On that basis, it could be argued that the payments are consideration, being a payment for the inducement of the supply of education services.

33 *Ward v Byham* [1956] 2 All ER 318 (CA).

34 *Williams v Williams* [1957] 1 All ER 305 (CA).

69. The relationship between students and the school board is based at least in part on the Education legislation: *Grant v Victoria University of Wellington*[35]; *A-G v Daniels*[36]. A statutory right exists to free education.[37] All children from the ages of 6 to 16 must be enrolled at a school.[38] This means school boards have a corresponding statutory obligation to provide education in state and state integrated schools free of charge. Although boards may represent that education services would not be supplied if payment is not made, the true legal nature of the transaction is that the board cannot require payment for the supply of education services as students have a statutory entitlement to receive education free of charge. This is clearly supported by Circular 2021/03.

70. In *Chatham Islands*, Tipping J commented at [25]:

> GST is payable on transactions. When deciding whether a particular transaction is of a kind which attracts GST, it is important to analyse carefully its legal characteristics.

No waiver of statutory right

71. A person may waive a statutory benefit conferred on that person under a statute if the waiver does not infringe some public right or public policy: *Bowmaker Ltd v Tabor*[39]; *Reckitt & Colman (NZ) Ltd v Taxation Board of Review*[40]. To determine whether a statutory right to free education can be waived, it is appropriate to consider whether the purpose of the legislation under which the right is conferred would be infringed by the waiver or contracting out: *Johnson v Moreton*[41]; *Lieberman v Morris*[42].

72. All domestic students aged from 6 to 16 must be enrolled at a registered school and attend the school.[43]

73. Parents can choose to have their children educated at non-state schools. It could be argued that in that sense the statutory entitlement to free education can be waived. However, the public policy objective expressed in The Statement of National Education and Learning Priorities[44] made under s 5 of the EATA 2020 and in s 127(1) of that Act is that all children are to receive education of a minimum standard. The provision of public funding for education and the entitlement to free education are intended to ensure cost is not a barrier to access to education.

74. Therefore, the right to free education is not solely a private right. If boards were able to impose a requirement for the payment of "fees" and individual parents were able to waive the right to free education, the purpose of the legislation would be infringed.

75. Although school boards have wide discretion to manage and control schools, such powers cannot be exercised in a manner inconsistent with a statutory provision.[45] The Commissioner's view is that school boards do not have the power to require payment as a condition of the provision of education or any other services or items that are properly regarded as being integral to the supply of education to which a statutory entitlement exists. This is confirmed in Circular 2021/03.

76. The Commissioner acknowledges that, given an illegal activity can be a taxable activity and given the definition of "consideration" does not require a contract to exist between the supplier and recipient for a payment to be consideration, payment need not be enforceable for the payment to be consideration. Therefore, the fact the transaction is invalid because the parties do not have the power to enter into a transaction, does not mean the transaction would not be recognised for GST purposes: *C & E Commrs v Oliver*[46]. However, the statutory entitlement to education cannot be altered by a representation that education services are conditional on the payment of "fees".

35 *Grant v Victoria University of Wellington* [2003] NZAR 185 (HC).

36 *A-G v Daniels* [2003] 2 NZLR 742 (CA).

37 Section 33 of the EATA 2020.

38 Sections 35 and 36 of the EATA 2020.

39 *Bowmaker Ltd v Tabor* [1941] 2 All ER 72 (CA).

40 *Reckitt & Colman (NZ) Ltd v Taxation Board of Review* [1966] NZLR 1,032 (CA).

41 *Johnson v Moreton* [1978] 3 All ER 37 (HL).

42 *Lieberman v Morris* (1944) 69 CLR 69 (HCA).

43 Sections 35 and 36 of the EATA 2020.

44 The Statement of National Education and Learning Priorities (NELP) and the Tertiary Education Strategy (TES) published on Ministry of Education website (accessed 8 March 2023) FULL-NELP-2020.pdf (education.govt.nz) [PDF, 150KB].

45 Section 131 of the EATA 2020.

46 *C & E Commrs v Oliver* [1980] 1 All ER 353 (QBD).

77. Therefore, contributions paid to the school board of a state school, whether for general or specific purposes, are not consideration for the supply of education services, even if there were a representation that school reports or other information relating to the assessment of students would be withheld unless payment was made (albeit contrary to the legal position). However, if school boards supplied other goods or services beyond the supply of education services on the basis that the supply was conditional on payment being made, the payment would be consideration for that supply.

78. If a contribution made includes a charge for an item that is beyond the supply of education services, such as a school magazine, a case may be made for apportionment of the payment. Section 10(18) states:

> Where a taxable supply is not the only matter to which a consideration relates, the supply shall be deemed to be for such part of the consideration as is properly attributable to it.

Conclusion | Whakataunga

79. Amounts paid by parents are not consideration for the supply of education services to which there is a statutory entitlement. This is for the following six reasons.

80. The first reason is that the definition of consideration under the Act is not the same as the contract law definition. A contract is not required between parents and school boards for the payments to be consideration for GST purposes: *Turakina*. However, for the payments to be consideration for a supply, a sufficient relationship must exist between payments and a supply: *NZ Refining*; *Chatham Islands*; *Suzuki*; *Trustee, Executors and Agency Co*.

81. The second reason is that because free education is a statutory right, when an amount is not paid for any particular purpose or for the undertaking of any specific obligation, a sufficient connection does not exist between the payments and a supply. This is so even though an expectation exists that the payments will be used for the taxable activity: *Chatham Islands*; *NZ Refining*. The fact the amounts parents pay to boards may be used to meet the cost of things not covered by the Crown grant does not establish the necessary connection that the amounts are paid for services of a particular nature: *Turakina*; *Chatham Islands*.

82. The third reason is that GST consequences are determined on the basis of the legal character of the transaction: *Chatham Islands*. The relationship between parents and school boards is based on the EATA 2020, which requires school boards of state and state integrated schools to provide education, entitles students at state schools to free enrolment and free education, and entitles students enrolled at state integrated schools to free education on the same terms and conditions as students in state schools. The true legal nature of the arrangement between parents and the school board is that school boards have a statutory obligation to provide free education and students have a right to free education. The supply of education services is not conditional on the payment being made, and payment is not required for the supply of education services.

83. The fourth reason is that it can be argued that where a representation is made that education services would be withheld if payment is not made, the payments would be made "in respect of, in response to or for the inducement of" the supply of education services. However, because a statutory entitlement to free education exists in state schools, the true legal position is that education services would be provided whether or not payment were made. Therefore, a sufficient connection would not exist between the payment of general or specific amounts and the supply of education services to which there is a statutory entitlement.

84. The fifth reason is that a statutory right conferred on a person may be waived only if the waiver does not infringe the purpose of the legislation: *Bowmaker Ltd*; *Reckitt & Colman*; *Johnson*; *Lieberman*. The purpose of the EATA 2020 is that all children should receive education of a minimum standard, and there should be no barriers to access to such education. That purpose would be infringed by a waiver of the right to free education and an ability of school boards to require the payment of "fees" for education.

85. The sixth and final reason is that the scope of the obligation to provide education services is defined by The Statement of National Education and Learning Priorities and s 127 of the EATA 2020, along with the school's strategic plan. The supply of school reports and other information relating to the assessment of students is integral to the supply of education services, and such information must be supplied free.[47] The amounts would not be consideration, even if there were a representation that the supply of such information would be withheld unless payment was made (albeit contrary to the legal position).

47 Section 165(3) of the EATA 2020

86. Therefore, GST is not payable on amounts paid by parents to school boards to assist the school with meeting the cost of delivering goods and activities that are an integral part of the curriculum that the school has a statutory obligation to provide and in which participation by pupils is compulsory. However, if other services not integral to the supply of those education services are supplied on the basis that the supply is conditional on payment being made, the payment will be consideration for that supply. If a separate charge is not made for such an item, apportionment may apply: s 10(18).

87. For payments made by parents to schools to be consideration, it must be possible to identify a supply of goods or services other than the supply of education services that the schools are obliged to supply. The two issues that need to be considered are:

- whether what is provided to students is within the scope of the statutory entitlement to education services; and
- if the supply made is for goods or services outside the scope of the statutory entitlement, whether a sufficient relationship exists between the supply and the payment for the payment to be consideration for those goods or services.

Examples | Tauira

88. The following eight examples explain the application of the law. The examples are consistent with the guidance in Circular 2021/03 for schools that have not opted or are ineligible to opt into the Donations Scheme. All of the students in the examples are domestic students.

Example | Tauira 1 – General donation

Each year the school board of a state school asks the parents of students enrolled at the school to make a financial contribution to assist with meeting school costs.

The board is not required to use the contribution for any particular purpose. The contribution is paid for the general purposes of the school, such as the school library, swimming pool and shared computer facilities, all of which are facilities available to any student.

The payment is not consideration for the supply of education services because there is a statutory entitlement for students to receive education free of charge. Because the payment is received for the general purposes of the school and the school board does not undertake any obligation to supply any goods or services in return for the payment, such payments are not consideration for any supply. Therefore, GST is not chargeable by the school board on the payments.

Example | Tauira 2 – Payment for materials

Students at a state school are asked to contribute towards the cost of materials used in a clothing class. The students are not required to take ownership of the completed item and will be entitled to ownership only if payment is made.

A charge cannot be made for the use of materials necessary for the delivery of education services to which a statutory entitlement exists. However, a charge can be made for the right to ownership of an item constructed using such materials. The payment is not consideration for the use of the materials, because the use of such materials is necessary for the provision of instruction in the subject. However, if a student elects to take the completed item home, the payment is consideration for the right to ownership of the item, and the board is liable to account for GST on the payment.

Example | Tauira 3 – Photocopying

In addition to a general school donation, parents of students at a state school are asked to pay photocopying charges for materials (such as articles, extracts from textbooks and homework exercises) used in teaching, even though such materials should be provided free of charge.

The payment is not consideration. It is implicit in the right to free education that there should be no charge for the cost of materials used in the delivery of the curriculum. The provision of photocopied materials necessary for teaching is integral to the supply of education services. GST is not chargeable on the payment.

However, if a student chooses to purchase their own copy of a photocopied school magazine produced by students, the payment made would be consideration for the supply of that item, and GST would be chargeable on the payment.

Example | Tauira 4 – School camp

Students at a state integrated school are asked by the board for a donation towards the costs of a school camp (such as a year 12 outdoor education camp or a year 9 beginning of the year camp). Attendance at the camp is a compulsory part of the school's curriculum.

The donation amount is not subject to GST. This is because the payment is not consideration for the supply of education services as students have a statutory entitlement to receive education free of charge. The camp forms part of the supply of education services by the school. The student is entitled to attend the camp regardless of whether payment is made. Therefore, the payment does not have the requisite relationship to any supply for it to be consideration.

Example | Tauira 5 – Ski trip

Each year, year 11 students have the option of going on a weekend ski trip to Mount Ruapehu. The trip is not compulsory and does not form part of the school's curriculum. Parents are asked to pay $200 to cover costs. Students whose parents do not pay in full are not entitled to attend the ski trip.

This payment is consideration for the right to participate in the ski trip. Therefore, GST is chargeable on the payment.

Example | Tauira 6 – Stationery and workbooks

A state school charges students for stationery packs and optional workbooks that students are entitled to keep. Parents may choose whether to purchase the stationery packs or workbooks from the school. The payment is made for the supply of the stationery and the workbook, so is consideration. Therefore, GST is chargeable on the payment. (The school may occasionally waive a payment for stationery by some students but this does not mean the payments for stationery made by other students are not made for the supply of stationery.)

Example | Tauira 7 – Visiting drama group

A drama group puts on a performance at a state school. Attendance by students is optional but if students choose to attend a charge is payable. The payment is consideration for the right to attend the performance, and GST is chargeable on the payment.

However, when students are required to attend a drama performance as a compulsory part of the curriculum, parents are not obligated to pay. Any payment by parents towards the cost of their child attending a compulsory performance will not be subject to GST.

Example | Tauira 8 – Advance payment of charges

The school board of a state integrated school asks parents of students enrolled at the school to make a single payment in advance, in return for future items to be supplied by the school, such as stationery and visiting drama groups, which the family has agreed to receive. The advance payment also includes an amount for a take-home item (such as a letterbox that will be made in workshop technology) that the student chooses to take home once they have built it.

These goods and activities are not integral to the supply of education that the school has a statutory obligation to provide. The payment is made for the right to participate in the activities to which the payment relates or for the right to ownership of an item. The entitlement of students to these rights is conditional on payment being made, and GST is chargeable on the payment.

References | Tohutoro

Expired rulings | Whakatau mōnehu

Public Ruling BR Pub 18/06 Goods and Services Tax - Payments made by parents to state and state integrated schools, *Tax Information Bulletin* Vol 30, No 7 (August 2018): 3 (expiring 20 June 2023)

Public Ruling BR Pub 14/06 Payments made by parents or guardians of students to state schools – GST treatment, *Tax Information Bulletin* Vol 26, No 9 (October 2014): 3 (expired)

Public Ruling BR Pub 09/01 Payments made by parents or guardians of students to state schools – GST treatment, *Tax Information Bulletin* Vol 21, No 3 (May 2009): 4 (expired)

Public Ruling BR Pub 03/04, *Tax Information Bulletin* Vol 15, No 7 (July 2003): 6 (expired)

Legislative references | Tohutoro whakatureture

Crown Entities Act 2004, s 7(1)(d)

Education Act 1989, s 61 (repealed)

Education and Training Act 2020, ss 5, 33, 35, 36, 90, 118, 127, 131, 138, 145, 550, 551, Schedule 6

Goods and Services Tax Act 1985, ss 2 ("consideration", "public authority"), 3(1)(ka), 5(6), 6(1)(b), 8, 10(2) and (18), 14(a), 14(1)(a)

Official Information Act 1982

Privacy Act 2020

Rating Powers Act 1988

Tax Administration Act 1994, s 91D

Case references | Tohutoro kēhi

A-G v Daniels [2003] 2 NZLR 742 (CA)

Bowmaker Ltd v Tabor [1941] 2 All ER 72 (CA)

C & E Commrs v Oliver [1980] 1 All ER 353 (QBD)

Case R34 (1994) 16 NZTC 6,190 (TRA)

Case U1 (1999) 19 NZTC 9,001 (TRA)

Chatham Islands Enterprise Trust v CIR (1999) 19 NZTC 15,075 (CA)

CIR v NZ Refining Co Ltd (1997) 18 NZTC 13,187 (CA)

Director-General of Social Welfare v De Morgan (1996) 17 NZTC 12,636 (CA)

Grant v Victoria University of Wellington [2003] NZAR 185 (HC)

Johnson v Moreton [1978] 3 All ER 37 (HL)

Lieberman v Morris (1944) 69 CLR 69 (HCA)

Maddever v Umawera School Board [1993] 2 NZLR 478 (HC)

Reckitt & Colman (NZ) Ltd v Taxation Board of Review [1966] NZLR 1,032 (CA)

Rotorua Regional Airport Ltd v CIR (2010) 24 NZTC 23,979 (HC)

Suzuki NZ Ltd v CIR (2001) 20 NZTC 17,096 (CA)

Taupo Ika Nui Body Corporate v CIR (1997) 18 NZTC 13,147 (HC)

Television NZ Ltd v CIR (1994) 16 NZTC 11,295 (HC)

Trustee, Executors and Agency Co NZ Ltd v CIR (1997) 18 NZTC 13,076 (HC)

Turakina Maori Girls College Board of Trustees v CIR (1993) 15 NZTC 10,032 (CA)

Ward v Byham [1956] 2 All ER 318 (CA)

Williams v Williams [1957] 1 All ER 305 (CA)

Other references | Tohutoro anō

Concise Oxford English Dictionary (12th ed, Oxford University Press, 2011)

Circular 2021/03: Payments by parents of students in schools (Ministry of Education, 2021)

Circular 2018/01: *Payments by Parents of Students in Schools* (Ministry of Education, 2018)

INTERPRETATION STATEMENT

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

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

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

Some interpretation statements may be accompanied by a fact sheet summarising and explaining the main points. Any fact sheet should be read alongside its corresponding interpretation statement to completely understand the guidance. Fact sheets are not binding on the Commissioner. Check **taxtechnical.ird.govt.nz/publications** for any fact sheets accompanying an interpretation statement.

IS 23/05: GST – Section 5(6D): Payments in the nature of a grant or subsidy

This interpretation statement considers the application of section 5(6D) of the Goods and Services Tax Act 1985. Section 5(6D) broadly provides that when a payment in the nature of a grant or subsidy is paid on behalf of the Crown or by a public authority to a person in respect of their taxable activity, then that payment is deemed to be consideration for a supply of goods and services in the course or furtherance of the taxable activity.

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

REPLACES | WHAKAKAPIA

- "GST and Compensation to Maori Organisations", *Tax Information Bulletin* Vol 4, No 7 (March 1993): 4
- "GST on Grants", *Tax Information Bulletin* Vol 4, No 7 (March 1993): 13

Summary | Whakarāpopoto

1. Section 5(6D) is a deeming provision in the Act that applies in certain circumstances where a payment in the nature of a grant or subsidy is made. The term "payment in the nature of a grant or subsidy" is interpreted according to the usual rules of statutory interpretation but section 5(6E) contains specific inclusions in and exclusions from the term.
2. Section 5(6D) only applies to payments made on behalf of the Crown or by any public authority.
3. Section 5(6D) covers a payment where it is made to:
   - any person in relation to or in respect of that person's taxable activity; or
   - any person for the benefit of and on behalf of another person in relation to or in respect of that other person's taxable activity.
4. Where a payment meets the requirements in [3], section 5(6D) operates to deem the payment to be consideration for a supply of goods and services by the person to whom or for whose benefit the payment is made, in the course or furtherance of that person's taxable activity. If they are a GST-registered person, they will have to account for output tax.
5. A payment in the nature of a grant or subsidy will have one or more of the following characteristics:
   - The Crown or another public body pays it gratuitously (without obligation) out of public funds.
   - The purpose of the payment is to further objectives in the public interest, and this may be done by lowering the price of a commodity or service.
   - The payment is often made to public, charitable or private bodies so that third parties can benefit.
   - The objective of the payment is to promote or encourage an industry or enterprise.
6. The legislation refers to a payment "in the nature of" a grant or subsidy. The words "in the nature of" extend the coverage of section 5(6D) to include payments that are not technically grants or subsidies.
7. The focus is on the character or quality of what the payer pays, and of the consideration they give, rather than on what the payee receives.

8. Where section 5(6D) applies, and the amount they receive means an unregistered person crosses the GST registration threshold of $60,000 per annum, they will need to register for GST and pay output tax on the payment. The proviso to section 51(1)(a) may apply, which excludes the need to register on the "backward-looking" test in section 51(1)(a).
9. Alternatively, if it is a requirement that the person spends the grant or subsidy on replacing any plant or other capital asset they use in their taxable activity, then the deemed supply under section 5(6D) may not trigger registration because of the proviso in section 51(1)(d).

Introduction | Whakataki

10. This interpretation statement replaces and updates the Commissioner's previous statements on section 5(6D). These statements are:
    - "Application of GST to Government Grants and Subsidies", *Tax Information Bulletin* Vol 3, No 1 (July 1991): 30;
    - "GST and Compensation to Maori Organisations", *Tax Information Bulletin* Vol 4, No 7 (March 1993): 4; and
    - "GST on Grants", *Tax Information Bulletin* Vol 4, No 7 (March 1993): 13.
11. This statement **does not** replace two other public items that discuss section 5(6D). These items are:
    - "Treaty of Waitangi Settlements – GST Treatment", *Tax Information Bulletin* Vol 14, No 9 (September 2002): 50; and
    - "GST Treatment of Funding Provided to Treaty of Waitangi Claimants by the Crown through the Office of Treaty Settlements", *Tax Information Bulletin* Vol 18, No 11 (December 2006): 37.
12. The two items listed in [11] cover generally the GST treatment of Treaty of Waitangi settlements and the funding provided to Treaty of Waitangi claimants and are not limited to section 5(6D). The conclusions in these items on section 5(6D) are consistent with the approach of this interpretation statement.

Analysis | Tātari

Background to, and overview of, section 5(6D)

13. Section 5(6D) was introduced into the Act in 1991 as a result of a Tax Review Authority decision (*Case M129* (1990) 12 NZTC 2,839). Here Barber DJ found that the Department of Labour's payment of a jobseeker subsidy to an employer did not amount to consideration for a taxable supply of services by the employer to the Department of Labour.
14. As a result of the case, section 2(1) of the Goods and Services Tax Amendment Act (No 3) 1991 introduced section 5(6D). Although the section was enacted on 28 June 1991, it took effect from 1 October 1986 (the date the Act came into effect) to ensure that the legislation reflected the government's original intention. (It included a savings provision for positions taken before 19 December 1990.)
15. Section 5(6D) provides:

> (6D) For the purposes of this Act, where any payment in the nature of a grant or subsidy is made on behalf of the Crown or by any public authority to—
>
> (a) any person in relation to or in respect of that person's taxable activity; or
>
> (b) any person for the benefit and on behalf of another person in relation to or in respect of that other person's taxable activity,—
>
> that payment shall be deemed to be consideration for a supply of goods and services by the person to whom or for whose benefit the payment is made in the course or furtherance of that person's taxable activity.

16. For section 5(6D) to apply, the payment must meet the following criteria:
    - there must be a payment in the nature of a grant or subsidy; and
    - the payment must be made on behalf of the Crown or by any public authority; and
    - the payment must be made to either:
        - a person in relation to or in respect of that person's taxable activity; or
        - a person for the benefit and on behalf of another person in relation to or in respect of that other person's taxable activity.
17. If the payment meets the criteria in [16], then the operative part of the section applies. That is, the payment is deemed to be consideration for a supply of goods and services by the person to whom or for whose benefit the payment is made, in the course or furtherance of that person's taxable activity.

18. When a payment is deemed a supply, it leads to other issues such as time of supply and GST registration.

A "payment in the nature of a grant or subsidy"

Ordinary meaning of "grant" and "subsidy"

19. Case law has found the dictionary definitions of "grant" and "subsidy" to be helpful in interpreting the law. It is useful to consider them before turning to that case law.

20. The *Concise Oxford English Dictionary* (12th ed, 2011, Oxford University Press, Oxford) defines "grant" and "subsidy" as follows:

> grant. n. a sum of money given by a government or public body for a particular purpose
>
> subsidy. n. 1. a sum of money granted from public funds to help an industry or business keep the price of a commodity or service low. • a sum of money granted to support an undertaking held to be in the public interest
> • a grant or contribution of money

21. The *Oxford English Dictionary* (online edition, 3rd ed, 2012, Oxford University Press[1]) gives an expanded definition of each term:

> grant n1.
>
> 3a. An authoritative bestowal or conferment of a privilege, right, or possession; a gift or assignment of money, etc. by the act of an administrative body or of a person in control of a fund or the like.
>
> subsidy, n.
>
> 3. a. *gen*. A donation of money or other property, usually made to provide assistance.
>
> …
>
> c. Money or a sum of money granted by the state or a public body to help keep down the price of a commodity or service, or to support something held to be in the public interest. Also: the granting of money for these purposes

22. In these dictionary definitions, the two terms have some features in common. They identify a public authority or government as providing the funds and contain a sense that the purpose of providing the funds is to further objectives in the public interest. Often the way of achieving this purpose is to lower the price of a commodity or service. This understanding that a public authority or government is providing the funds is consistent with the specific requirements of section 5(6D) that the payment is on behalf of the Crown or by any public authority.

23. New Zealand case law deals with the meaning of "in the nature of a grant or subsidy", but in considering another provision of the Act – the second proviso to section 78(2) (inserted with effect from 23 March 1989 by section 20 of the Finance Act 1989). Section 78 covers the effect of imposing or altering the rate of GST. Section 78(2) provides for the modification of an agreement or contract to allow the supplier to change the agreed price to take account of the tax change. The second proviso is that the rule in subsection (2) does not apply to require a public authority to alter any amount it is to pay for any supply of goods and services where the consideration for that supply is "in the nature of a grant or subsidy".

24. The two relevant cases are *Director-General of Social Welfare v De Morgan and another* (1996) 17 NZTC 12,636 (CA) and *Kena Kena Properties Limited v Attorney-General* (2002) 20 NZTC 17,433 (PC). The cases involved substantially similar facts, involving Department of Social Welfare payments to rest home operators to help residents of those rest homes with the cost of living there.

25. After the change in GST rates in 1989 (from 10% to 12.5%), the Department refused to compensate for the increase in GST by increasing the amount of its payment to the rest home operators. The operators sought to apply the rule in section 78(2) to increase the payments. The Department relied on the second proviso to section 78(2) as support for its view that it did not need to increase the amount it paid as a result of the increase in the GST rate. The Court of Appeal in *De Morgan* and the Privy Council in *Kena Kena Properties* both found in favour of the Department of Social Welfare.

1 Accessed 9 March 2023.

26. In *De Morgan*, Richardson P explained (at 12,641) that the words "in the nature of" extend the coverage of section 5(6D) so that, even if the payments are not technically a grant or subsidy, the subsection will apply if the payment is within the nature of a grant or subsidy.
27. His Honour also concluded that:
    - the focus is on the character or quality of what the payer pays and of the consideration they give, rather than what the payee receives in their hands;
    - the authority for making the payments is relevant (in this case, a scheme with the purpose of granting special assistance under any welfare programme); and
    - the description of the payment as a "subsidy" and the ultimate purpose of supporting the rest home residents were relevant.
28. The Privy Council in *Kena Kena Properties* endorsed the Court of Appeal decision in *De Morgan*. It further observed that:
    - most grants or subsidies will be made to public, charitable or private bodies so that third parties can benefit;
    - grants or subsidies are made because it is considered in the public interest to enable such bodies to provide accommodation, health services, cultural events and so on to members of the public at a concessionary rate; and
    - the body in question may not itself be the intended beneficiary of the grant or subsidy.
29. Overseas case law on what is a "grant" or "subsidy" appears in Canadian and Australian cases such as:
    - *GTE Sylvana v R* [1974] 1 FCR 726;
    - *Placer Development Ltd v Commonwealth of Australia* (1969) 121 CLR 353 (HCA);
    - *Reckitt & Colman Pty Ltd v FCT* 74 ATC 4185 (Supreme Court of New South Wales); and
    - *First Provincial Building Society Limited v FCT* 95 ATC 4145 (Full Federal Court).
30. These cases, together with the New Zealand case law, establish that a grant or subsidy has one or more of the following characteristics:
    - The Crown or another public body pays it gratuitously (without obligation) out of public funds.
    - The objective of the payment is to further objectives in the public interest and lowering the price of a commodity or service may achieve this objective.
    - The payment is often made to public, charitable or private bodies so that third parties can benefit.
    - The objective of the payment is to promote or encourage an industry or enterprise.
31. Individual circumstances also need to be considered. For example, in *De Morgan* the authority for making the payments was relevant (a scheme with the purpose of granting special assistance under any welfare programme). Also relevant was the description of the payment as a "subsidy" and the ultimate purpose of supporting the rest home residents.
32. Whether a payment is a grant or subsidy is not determined by the description used by the parties to describe the payment. In this regard the principle from *Marac Life Assurance v CIR* (1986) 8 NZTC 5086, 5097-8 (CA) (per Richardson J) applies. His Honour said:

> The true nature of a transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and carried out: not on an assessment of the broad substance of the transaction measured by the results intended and achieved or of the overall economic consequences. **The nomenclature used by the parties is not decisive and what is crucial is the ascertainment of the legal rights and duties which are actually created by the transaction into which the parties entered**. The surrounding circumstances may be taken into account in characterising the transaction. Not to deny or contradict the written agreement but in order to understand the setting in which it was made and to construe it against that factual background having regard to the genesis and objectively the aim of the transaction. Of course the documentation may be a sham hiding the true agreement or its implementation. Or there may be a statutory provision mandating a broader or different approach. But at common law there is no halfway house between sham and characterisation of the transaction, according to the true nature of the legal arrangements actually entered into and carried out.
>
> (Emphasis added.)

Section 5(6E) definition of "payment in the nature of a grant or subsidy"

33. As well as this analysis of the meaning of "grant" or "subsidy" in section 5(6D) there is also the need to consider the definition in section 5(6E). This provides a number of specific rules for what is included and not included in the term "payment in the nature of a grant or subsidy". The two specific inclusions are (section 5(6E)(a)):

    (i) any suspensory loan or advance, when that loan or advance becomes non-repayable by reason of its conditions for non-repayment being satisfied; and

    (ii) any payment in the nature of a grant or subsidy of a kind that is declared by the Governor-General by Order in Council to be a taxable grant or subsidy for the purposes of subsection (6D), being a payment that, but for such declaration, would be excluded from this definition by virtue of paragraph (b)(ii):

34. At present, in terms of section 5(6E)(a)(ii), there is no Order in Council declaring an amount to be a taxable grant or subsidy.

35. There are three exclusions from the term "payment in the nature of a grant or subsidy" (section 5(6E)(b)):

    (i) any payment of a benefit paid under the Social Security Act 2018; or

    (ii) subject to paragraph (a)(ii), any other payment made to a person where the payment is for the personal use and benefit of the person or, as the case may be, a relative (as defined in paragraph (a) of the definition of that term in section YA 1 of the Income Tax Act 2007) of the person; or

    (iii) any payment of a kind that is declared by the Governor-General by Order in Council not to be a taxable grant or subsidy for the purposes of subsection (6D).

36. These exclusions cover social welfare benefits, payments made to a person for their personal use and benefit (in contrast to being in relation to a taxable activity), and payments declared by Order in Council not to be a taxable grant or subsidy for the purposes of section 5(6D). The Schedule to the Goods and Services Tax (Grants and Subsidies) Order 1992 has a list of payments declared not to be taxable grants or subsidies for the purposes of section 5(6D). These include earthquake subsidy payments in relation to the Christchurch and Kaikoura earthquakes and certain Covid-19 payments.

Payment made on behalf of the Crown or by any public authority

37. It will normally be straightforward to establish whether a payment meets the section 5(6D) requirement that it is made on behalf of the Crown or any public authority. The Act has its own definition of "public authority" (in section 2(1)) as follows:

> **public authority** means all instruments of the Crown in respect of the Government of New Zealand, whether departments, Crown entities, State enterprises, or other instruments; and includes offices of Parliament, the Parliamentary Service, the Office of the Clerk of the House of Representatives, public purpose Crown-controlled companies, and the New Zealand Lottery Grants Board; but does not include the Governor-General, members of the Executive Council, Ministers of the Crown, or members of Parliament

38. It is worth observing the four exclusions from the term "public authority" at the end of that definition, namely:

- the Governor-General;
- members of the Executive Council;
- Ministers of the Crown; and
- members of Parliament.

Payment made to a person in relation to or in respect of that person's taxable activity – section 5(6D)(a)

39. Section 5(6D)(a) concerns the situation where a payment in the nature of a grant or subsidy is made to "any person … in relation to or in respect of that person's taxable activity". Section 5(6E)(b)(ii) provides that a "payment in the nature of a grant or subsidy" does not include a payment made to a person where the payment is for the personal use and benefit of the person or a relative of the person.

40. Accordingly, the statutory scheme makes it clear that section 5(6D) only covers payments relating to taxable activities. It does not extend to all payments to GST-registered persons (subject to the Order in Council process in section 5(6E)(a)(ii) – which has not been used to date).

41. Case law establishes that the words "in relation to or in respect of" are words of "the widest import" (*Shell New Zealand Limited v CIR* (1994) 16 NZTC 11,303 (CA)). (Although *Shell* was an income tax case, there is no reason for interpreting the words in a different way in a GST context.) In the *First Provincial* case mentioned at [29], Hill J was considering a subsidy

received "in relation to" the carrying on of a taxpayer's business. His Honour found that the words "in relation to" were intended to extend the section (the first part of which covered a subsidy a taxpayer received in "carrying on" a business) and indicated a wider relationship between a subsidy and the taxpayer's business.

42. As a result, it can be expected that a court would interpret the required link between a grant or subsidy and the person's taxable activity widely. However, in practice it is unlikely that this will give rise to significant uncertainty as it would be expected that someone who pays a grant or subsidy will usually carefully explain the reasons why they are making the payment, who they are paying it to, and what the payment is for. The accountability requirements on the Crown and public authorities in respect of payments in the nature of a grant or subsidy should provide sufficient detail to determine whether section 5(6D)(a) is engaged.

43. Obviously the person receiving the grant or subsidy needs to have a taxable activity if section 5(6D) is to apply to them. If they do not have a taxable activity, the rule in section 5(6E)(b)(ii) is likely to apply (as the payment will be in their private capacity). Receiving a grant or subsidy does not create a taxable activity where there is not one. However, if the grant or subsidy is paid to help a person to start a taxable activity, that will be enough to engage section 5(6D)(a) because section 6(2) of the Act provides that "anything done in connection with the beginning … of a taxable activity is treated as being carried out in the course or furtherance of the taxable activity".

44. Where a grant or subsidy is paid in relation to or in respect of a taxable activity **and** some other matter then an apportionment may be required. For example, if a payment relates to both a person's taxable activity and to an activity involving the making of exempt supplies (excluded from the definition of "taxable activity" by section 6(3)(d)) then section 10(18) would apply to apportion the consideration between the deemed supply in section 5(6D) and the other matter (the exempt activity). Only the portion relating to the taxable activity would be subject to GST under section 5(6D).

45. For more on section 10(18) see IS3387 (*GST treatment of court awards and out of court settlements*) and IS20/05 (*GST – supplies of residences and other real property*).

Payment made to any person for the benefit and on behalf of another person in relation to or in respect of that other person's taxable activity – section 5(6D)(b)

46. Section 5(6D)(b) provides for a situation where the person who receives a payment is not the intended beneficiary of the funds paid. In this situation, the first recipient of the funds is not liable to account for GST. Instead, the person who ultimately receives the funds will have to account for GST (assuming they are GST registered and the funds are in relation to or in respect of their taxable activity).

47. *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075 (CA) provides support for this view. In that case, the Crown had provided funding to the Chatham Islands Enterprise Trust and claimed that the trust had GST output tax obligations as a result. One basis for this claim was that section 5(6D) applied. The Court of Appeal found that the trust was not conducting a taxable activity and so section 5(6D)(a) did not apply. In discussing section 5(6D)(b), the Court of Appeal observed at [22] that:

> Counsel for the Commissioner abandoned any reliance on s 5(6D)(b), recognising that if it applied and the Crown's payments could truly be said to be for the benefit of the trading companies [owned by the Trust], the tax would be recoverable from them, not from the Trust. In any event, we found persuasive Mr Jenkin's submission that para (b) is referring to the receipt of payment in the capacity of an agent and that the payments in this case were not received on that basis, but were payments to the Trust itself to be dealt with in its discretion in terms of the deed.

48. For the rule in section 5(6D)(b) to cover a payment in the nature of a grant or subsidy, the payment must be both:
    - to a person for the benefit and on behalf of another person; and
    - in relation to or in respect of that other person's taxable activity.

49. A payment will satisfy the first of the two criteria in section 5(6D)(b) when it is made to a person for the advantage or profit of another person, and it is made to a person as agent or representative of that other person.

50. For discussion of the second of the two criteria (the payment must be in relation to or in respect of the other person's taxable activity), see from [40]. The same analysis applies here but with the focus on whether the person who eventually receives the payment, rather than the person who first receives the payment, has a taxable activity.

51. The challenge in applying section 5(6D)(b) is to determine when the facts establish that a person is receiving funds on behalf of and for the benefit of a third party. That will obviously depend on what the legal arrangements involve, and the legal rights and responsibilities of the parties. To reach a conclusion, it will be necessary to assess the individual situation.

52. Some examples of situations where this issue might arise are where the Crown:
    - makes payments to a body for it to distribute to individual grant recipients;
    - makes a grant to a national body, which the national body then distributes to individual member organisations; or
    - makes a grant to a parent company, which the parent company then passes on to a subsidiary company.
53. Section 56 of the Act allows a registered person carrying on a taxable activity in branches or divisions to apply for any such branch or division to be registered as a separate registered person. Section 56(2) indicates the requirements to allow such a separate registration, but once the separate registration is approved the taxable activity of the branch or division is deemed not to be carried on by the original registered person. The registration takes place under section 51 in the usual manner.

Payment of a grant or subsidy via an intermediary

54. Section 5(6D)(b) can apply in situations where an intermediary or "delivery agent" receives an amount of a grant or subsidy payment for distribution to recipients, including situations where the intermediary or delivery agent has discretion as to the recipients of the grant or subsidy money. (However, the grant or subsidy payment must be made on behalf of the Crown or by any public authority.)
55. In such a situation the intermediary or delivery agent will not need to account for GST on the payments as that is the responsibility of the ultimate recipient of the grant or subsidy. This assumes that any grant or subsidy that is paid to the intermediary or delivery agent is distributed to ultimate recipients of the payment or returned to the payer if the funds are not so distributed.

A payment that meets the section 5(6D) criteria is deemed to be consideration for a supply of goods and services by the person to whom or for whose benefit the payment is made in the course or furtherance of that person's taxable activity

56. If the person is GST registered, they will be required to account for GST output tax when they receive the payment.
57. The deemed supply under section 5(6D) is subject to the normal time of supply rules in section 9(1). (The payment or issue of an invoice, whichever is earlier, will trigger the time of supply.)
58. The deemed supply under section 5(6D) may also have consequences for GST registration under section 51. Given that section 5(6D) only applies where the person who receives a grant or subsidy has a taxable activity, the relevant section 51 consequence is for persons with a taxable activity who are below the GST registration threshold ($60,000 per annum) and who are not voluntarily registered for GST. If such a person receives a grant or subsidy covered by section 5(6D), then it may appear that that could push them above the $60,000 threshold so that they would have to register for GST. This issue is discussed from paragraphs 59 to 66.

Registration under section 51(1)(a)

59. This is the backward-looking test from the end of a month where the total value of supplies in that month and the preceding 11 months exceeds $60,000. This could be affected by the receipt of a grant or subsidy.

Proviso to section 51(1)(a)

60. However, GST registration may not be required under section 51(1)(a) if the proviso to that paragraph applies. The proviso states:

> provided that a person does not become liable to be registered by virtue of this paragraph where the Commissioner is satisfied that the value of those supplies in the period of 12 months beginning on the day after the last day of the period referred to in the said paragraph will not exceed that amount:

61. Therefore, if a grant or subsidy was a one-off payment that was not going to be repeated, and the Commissioner considers that the value of supplies in the next 12 months is not going to exceed $60,000, then the person would not need to register for GST. As a result, they would not be liable for GST output tax when they received a grant or subsidy.

Proviso in section 51(1)(d)

62. GST registration may also not be required under section 51(1) if the proviso to section 51(1)(d) applies. That proviso states that:

> provided that any such person shall not become liable where the Commissioner is satisfied that that value will exceed that amount in that period solely as a consequence of—
>
> ...
>
> (d) the replacement of any plant or other capital asset used in any taxable activity carried on by that person;

63. So, if the person exceeds the registration threshold because they have replaced any plant or other capital asset used in the taxable activity, then they will not be required to register.

64. A grant or subsidy may be of a capital nature (see *First Provincial*). No matter what the nature of the grant or subsidy, the rule in section 5(6D) would still apply to deem the person receiving the grant or subsidy to have made a supply. However, that supply may not count towards the GST registration threshold in section 51(1) **if** it can be established that the grant or subsidy relates to the replacement of any plant or other capital assets that the person receiving the grant or subsidy uses in any taxable activity they carry on.

65. For this proviso to apply, the person would need to be able to prove that the grant or subsidy was only paid on condition that they used it to replace any plant or other capital asset. Without a definite link between the grant or subsidy and the replacement of plant or other capital asset, it would not be possible to state that the person exceeded the threshold "solely as a consequence" of such replacement.

66. An example is where a person had a taxable activity with annual supplies of $50,000 and received a grant of $40,000. If they chose (but were not required) to put that grant towards upgrading a machine they used in their taxable activity, then the proviso in section 51(1)(d) would not apply (but the proviso to section 51(1)(a) would still apply in these circumstances). But if the grant was given only on condition that the person replaced the machine, and they used the grant for this purpose, then the proviso in section 51(1)(d) could apply.

Flowchart

67. The following flowchart illustrates the process of applying section 5(6D).

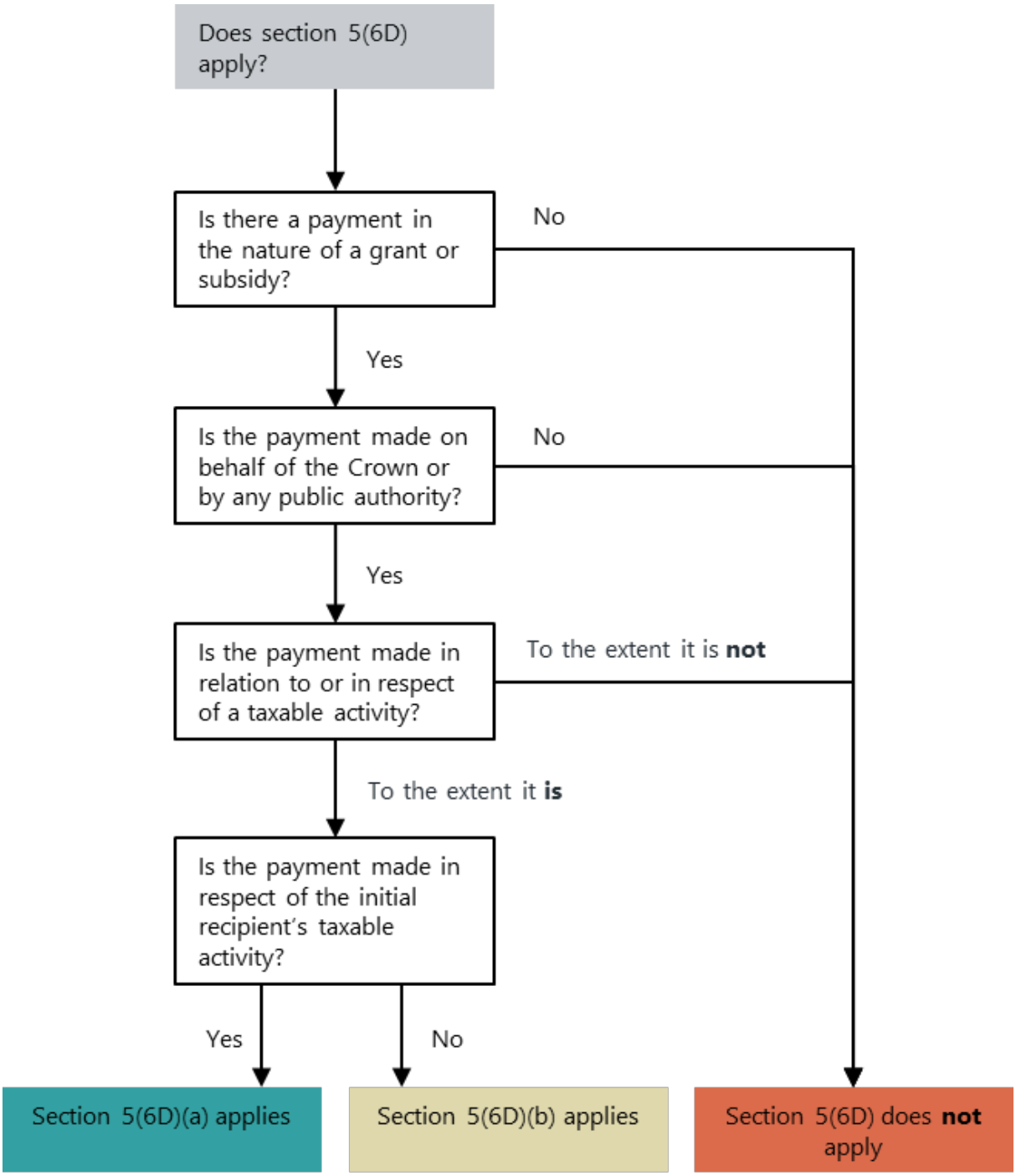

Figure | Hoahoa 1

Outline of the flowchart process.

1. Does section 5(6D) apply?
    1.1. Forward to 2.
2. Is there a payment in the nature of a grant or subsidy?
    2.1. **If No,** Forward to 8.
    2.2. **If Yes,** Forward to 3.
3. Is the payment made on behalf of the Crown or by any public authority?
    3.1. **If No,** Forward to 8.
    3.2. **If Yes,** Forward to 4.
4. Is the payment made in relation to or in respect of a taxable activity?
    4.1. **If To the extent it is not,** Forward to 8.
    4.2. **If To the extent it is,** Forward to 5.
5. Is the payment made in respect of the initial recipient's taxable activity?
    5.1. **If No,** Forward to 7.
    5.2. **If Yes,** Forward to 6.
6. Section 5(6D)(a) applies.
7. Section 5(6D)(b) applies.
8. Section 5(6D) does **not** apply.

Examples | Tauira

Example | Tauira 1 – Payment in the nature of a grant or subsidy

The Anti-Graffiti League (AGL) is a not-for-profit body set up to remove graffiti from public places in the interest of community enjoyment of those spaces. The Department of Community Beautification (DCB), a government department, supports the aims of the AGL and pays it a sum of $100,000 to put towards its activity of removing graffiti. The DCB places constraints on the AGL's use of the money, as well as setting accounting and reporting requirements.

The DCB's payment to the AGL is a "payment in the nature of a grant or subsidy". It makes the payment gratuitously out of public funds, with the purpose of furthering objectives in the public interest and promoting or encouraging an enterprise.

Example | Tauira 2 – Payment not in the nature of a grant or subsidy

The Department of Community Beautification (DCB) is so impressed by the achievements of the Anti-Graffiti League (AGL) in removing graffiti and beautifying public places that it enters into a contract with the AGL for the AGL to provide ongoing maintenance of high-profile public places throughout New Zealand, including public monuments, parks, and tourist sites. The DCB pays the AGL $250,000 per year for this work and the parties agree to a level of services of a specified quality that the AGL will provide at each specified place.

The DCB's payment to the AGL is not a "payment in the nature of a grant or subsidy" and will not come within section 5(6D). It is instead a normal commercial contract in which both parties provide consideration. The arrangement between the parties will, however, satisfy the normal meaning of a supply within section 5(1) and, in light of the activity undertaken, will mean that the AGL will need to account for GST on the payment in the usual way.

Example | Tauira 3 – Payment made on behalf of the Crown or by a public authority

The Department of Extinct Languages (DEL), a government department, makes a grant payment of $200,000 to the Proto-Norse Language Society (PNLS) to encourage its research into ancient Norse and the translation of myths and legends from that language.

The grant is a payment by a "public authority" as the DEL is a government department. As such, the payment may come within section 5(6D) if it also meets the other requirements of the section (and if so there will be GST consequences for the PNLS).

Example | Tauira 4 – Payment not made on behalf of the Crown or by a public authority

Thorin Thorsson is an eccentric philanthropist and fan of Proto-Norse languages. He decides to match the grant of the Department of Extinct Languages (DEL) to the Proto-Norse Language Society (PNLS) and pays $200,000 to the PNLS.

The grant is not a payment by a "public authority" as Thorin Thorsson does not satisfy the definition of being a "public authority". Section 5(6D) will not cover his grant. (However, depending on the terms of the payment, and what the PNLS has to do in return for it (if anything), there may be GST consequences for the PNLS.)

Example | Tauira 5 – Payment made in relation to or in respect of a person's taxable activity

Alpaca Rescue is an organisation that rehomes abandoned alpacas. It makes supplies of animals for a consideration to members of the public, and as such has a taxable activity. The Department of Unloved Animals (DUA), a government department, is concerned that Alpaca Rescue is struggling to find homes for all the alpacas it has rescued and may not be able to feed and care for them in the interim. The DUA pays a grant of $500,000 to Alpaca Rescue to support the organisation's mission of rehoming and caring for abandoned alpacas.

The grant is a payment to Alpaca Rescue "in relation to or in respect of" Alpaca Rescue's taxable activity of supplying rescued alpacas to members of the public. The payment satisfies section 5(6D)(a) and Alpaca Rescue will need to account for GST on the grant.

Example | Tauira 6 – Payment not made in relation to or in respect of a person's taxable activity part 1

Yak Rescue is an organisation that cares for abandoned yaks, with a vision that these yaks can see out their days at the Yak Sanctuary. Rescued yaks are not sold, and Yak Rescue does not conduct tours for consideration or make any other supplies for consideration. Carol Bee, a wealthy yak lover, supports the sanctuary financially. The Department of Unloved Animals (DUA) pays a grant of $250,000 to Yak Rescue to support the organisation's work in caring for abandoned yaks.

The grant is not a payment "in relation to or in respect of" a taxable activity because Yak Rescue does not make supplies for consideration, so it does not have a taxable activity. The payment does not satisfy section 5(6D)(a) and Yak Rescue is not liable to pay GST on the grant.

Example | Tauira 7 – Payment not made in relation to or in respect of a person's taxable activity part 2

A religious order runs a non-profit body called Making Lives Better (MLB) that exists to improve the lives of disadvantaged people. MLB is headquartered in Auckland and has a facility in Auckland where it undertakes a number of activities specifically designed to encourage disadvantaged women to participate in the workforce. These include providing subsidised childcare and employment skills training. Additionally, in Christchurch MLB runs a soup kitchen for homeless people, where simple meals are provided for no consideration.

The government makes a grant of $250,000 to MLB in relation to the Christchurch soup kitchen, to assist with the daily running of the facility.

This grant is not covered by section 5(6D) as the payment is not "in relation to or in respect of" MLB's taxable activity and MLB is not liable to pay GST on the grant. While MLB does have a taxable activity (because it makes supplies for consideration in respect of its Auckland-based activities) the Christchurch soup kitchen does not involve the making of supplies for consideration so as to be a taxable activity in its own right and has an insufficient connection with the taxable activity of MLB carried on in Auckland. The Christchurch activity is geographically separate, as well as having a very different nature to the Auckland childcare and skills training activities. Although it arises as a result of the same overall objective as that which led to the Auckland activities, that is not sufficient to link the activities together within one taxable activity.

Example | Tauira 8 – Payment made in relation to or in respect of a person's taxable activity and another matter

Trafford Castle is a nationally important heritage site. It has a taxable activity which includes castle tours, a café, a shop, venues for concerts and conferences, and so on. It also has a separate accommodation block which was previously the stables for the castle. The accommodation is used as long-term rental accommodation, and the supplies in respect of it are exempt supplies under section 14(1)(c). Both the castle and the accommodation operations are running significant financial deficits. The Ministry for Castles is a government department set up to support the preservation of the country's castles. It pays a grant of $2,500,000 to Trafford Castle to support its operations. The terms of the grant from the Ministry provide that $2 million is paid for support of the operations of the castle itself, and $500,000 is paid in respect of running the accommodation activity carried on through the former stables. The terms require that the funds are used strictly according to the terms of the grant.

Section 10(18) can be applied to apportion the consideration paid by the Ministry for Castles. $2 million of the grant is a payment "in relation to or in respect of" Trafford Castle's taxable activity. The payment satisfies section 5(6D)(a) and Trafford Castle will need to account for GST on this part of the grant.

$500,000 of the grant is a payment "in relation to or in respect of" Trafford Castle's exempt activity of making exempt supplies of residential accommodation. The payment does not satisfy section 5(6D)(a) and Trafford Castle is not liable to pay GST on this part of the grant.

Example | Tauira 9 – Payment to any person for the benefit and on behalf of another person – part one

The Cassette Tape Association (CTA) is an organisation dedicated to the preservation of the iconic audio cassette tape. The CTA has a taxable activity, which includes running seminars and exhibitions, selling memorabilia, and selling cassette tape players and audio cassettes. It has a head office and 18 regional branches. Each branch is individually registered for GST, because each meets the requirements of section 56(2).

The Department of Vintage Technologies (DVT), a government department, wishes to support the aims of the CTA and makes a grant of $400,000 to the head office of the CTA. The conditions of the grant are that each separate regional branch is to receive $20,000 and the head office may keep $40,000.

The CTA should account for the grant payment it received in the following way:

- The $40,000 for the head office comes within section 5(6D)(a) as a payment to the head office in relation to or in respect of the head office's taxable activity. The head office should account for GST on this amount.
- The $20,000 paid for the benefit and on behalf of each regional branch comes within section 5(6D)(b) as a payment to the head office "for the benefit and on behalf of" each regional branch in respect of each branch's taxable activity. Each branch should account for GST on this amount.

Example | Tauira 10 – Payment to any person for the benefit and on behalf of another person part two

Fergie's Bay has recently been hit by a natural disaster which has severely affected many farms, orchards, and other businesses in the area.

The government pays an immediate grant of $1 million to the Fergie's Bay Business Association (the FBBA) to assist with supporting affected businesses in the clean up after the natural disaster. All grant applicants are GST registered. The FBBA is engaged to receive and process grant applications and to distribute funds when decisions have been made. The FBBA accepts the grant funding in an agency capacity, and any undisbursed funds must be returned to the government.

The grant payment received should be accounted for in the following way:

- None of the funds received by FBBA come within section 5(6D)(a) as none of the funds relate to the FBBA's taxable activity.
- The funds paid by the FBBA to grant applicants come within section 5(6D)(b) as payments are "for the benefit and on behalf of" each applicant in respect of each applicant's taxable activity. Each applicant should account for GST on this amount.
- Any funds returned to the government do not give rise to any GST consequences under section 5(6D).

Example | Tauira 11 – Payment to any person not for the benefit and on behalf of another person

The Laser Disc Revival Society (LDRS) is dedicated to the revival of the laser disc as an audio-visual technology. It is registered for GST and has a head office and six branches. Each branch is individually registered for GST, because each meets the requirements of section 56(2). The LDRS undertakes a series of activities, such as selling laser disc players and discs, repairing existing players, and running seminars and exhibitions.

The Department of Vintage Technologies (DVT) wishes to support the LDRS and makes a grant of $200,000 to the head office of the LDRS. It sets the conditions that the grant must go towards the objectives of the organisation and the LDRS must meet accountability and reporting requirements, but it leaves how to use and disburse the funds to the discretion of the LDRS. The LDRS head office keeps $80,000 for its own operations and distributes $20,000 to each of the branches to support their operations.

The LDRS should account for the payment it receives in the following way:

- The $200,000 paid to the head office is all within section 5(6D)(a) as a payment to the head office in relation to or in respect of the head office's taxable activity. Nothing in the terms of the grant suggests that the head office is receiving the funds for the benefit and on behalf of another person in relation to or in respect of that other person's taxable activity. It is simply the head office's choice to distribute the funds it has received to its branches; the terms of the grant do not oblige it to do so. The head office should account for GST on this amount.
- Section 5(6D)(b) does not apply to any of the grant funds so as to require the branches to return GST on the amount they receive from the head office.

Example | Tauira 12 – GST registration part 1

The New Zealand Moa Revival Society (NZMRS) is an organisation promoting efforts to revive the extinct moa by developing new scientific techniques that might lead to the reintroduction of the moa (via ostrich surrogates). The NZMRS has a taxable activity but, because it is below the GST registration threshold, is not required to register for GST and has not voluntarily registered for GST. The Department of Extinct Birds (DEB), a government department, pays a grant of $100,000 to the NZMRS to assist with the funding of the required research. The NZMRS is to spend the grant as it sees fit. The parties agree that the payment is in relation to or in respect of the taxable activity of the NZMRS.

Does the payment mean that the NZMRS needs to register for GST on the basis that its taxable supplies now exceed the $60,000 threshold?

Under section 51(1)(a)[2] a person becomes liable to be registered at the end of any month where the total value of supplies made in New Zealand in that month and the 11 months preceding the month in the course of carrying on all taxable activities exceeds $60,000. Because section 5(6D) deems the $100,000 grant paid to the NZMRS to be consideration for a supply of goods and services by the NZMRS in the course or furtherance of its taxable activity, it would first appear that the NZMRS would be liable to register under section 51(1)(a).

However, the proviso to section 51(1)(a) states that a person **does not** become liable to be registered where the Commissioner is satisfied that the value of supplies in the period of 12 months beginning on the day after the last day of the period referred to in paragraph (a) will not exceed $60,000. As such, **if** the grant is a one-off payment and not expected to be repeated annually, the proviso will apply, and registration will not be required under section 51(1)(a). (This assumes the current level of taxable supplies is expected to continue.)

2 The "backward-looking" test.

Example | Tauira 13 – GST registration part 2

The Huia Cloning Project (HCP) is an organisation seeking to revive the extinct huia by extracting DNA from existing stuffed birds, feathers and skins. It has set up a laboratory to work on this objective. Although it has a taxable activity, its annual supplies fall below the GST registration threshold, and it has not voluntarily registered for GST.

The existing laboratory equipment is not sufficient for the current work programme, so the HCP seeks a $150,000 grant from the Department of Extinct Birds (DEB) to purchase new equipment. The DEB makes the payment. The terms of the grant provide that the DEB makes the payment on condition that the HCP uses the money only to replace the laboratory equipment, and that it must return any of the grant that it does not spend on such equipment.

The HCP purchases the new equipment, which costs $175,000 – that is, the HCP fully uses the grant in purchasing new equipment. The parties agree that the payment is in relation to or in respect of the HCP's taxable activity.

Does the payment mean that the HCP needs to register for GST on the basis that its taxable supplies now exceed the $60,000 threshold?

Many features are consistent with Example 12. It might first appear that section 51(1)(a) would apply to require the HCP to register for GST (the deeming rule in section 5(6D) pushing the organisation over the registration threshold). The proviso to section 51(1)(a) would then apply such that registration would not be required.

In addition to the proviso to section 51(1)(a) the proviso in section 51(1)(d) may also apply. This provides that a person will not become liable to register where the Commissioner is satisfied that the registration threshold will be exceeded **solely** as a consequence of the replacement of any plant or other capital asset used in any taxable activity that the person carries on.

In this case, the HCP has exceeded the GST registration threshold only because it received the $150,000 grant from the DEB, and the DEB only paid the grant on the condition that the HCP use the money to replace any "plant or other capital asset" (in this case, the laboratory equipment). Therefore, the proviso to section 51(1)(d) also applies and provides another reason why the HCP will not be required to register for GST and return GST output tax on receiving the payment from the DEB.

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IS 23/06: Income tax – Government payments to businesses (grants and subsidies)

This interpretation statement provides guidance on how ss CX 47 and DF 1 apply to payments of grants and subsidies to businesses. Where these provisions apply, a grant or subsidy paid by a local authority, public authority or public purpose Crown-controlled company to a business is not taxable and the expense funded by the grant is non-deductible.

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

Summary | Whakarāpopoto

1. Sections CX 47 and DF 1 (the grant provisions) are specific provisions that apply to payments in the nature of a grant or subsidy from a local authority, public authority or public purpose Crown-controlled company (PPCCC) to a business. The grant provisions are intended to make grants tax neutral to a business. That is, s CX 47 treats the payments as non-taxable and s DF 1 treats expenses funded by such payments as non-deductible.
2. This means that expenses that are usually deductible are no longer deductible (to the extent that the grant funds the expense). For depreciable property, the cost base of the asset acquired, constructed, installed, or extended by grant funds, is reduced by the amount of the payment. Depreciation loss is calculated based on the reduced cost.
3. A payment in the nature of a grant or subsidy has one or more of the following characteristics:
   - it is paid gratuitously (without obligation) out of public funds by the Crown or another public body;
   - it is paid to further objectives in the public interest;
   - it is often made to public, charitable or private bodies to confer benefits on third parties; and
   - it is made to promote or encourage an industry or enterprise.
4. In many cases it will be clear when the grant provisions apply, for example where the payment is:
   - paid by a public authority, local authority or PPCCC;
   - in the nature of a grant or subsidy;
   - paid to a business for use in the business; and
   - funding deductible or depreciable expenditure and is fully spent on that expenditure.
5. In many cases, it will also be clear when the grant provisions do not apply, for example where the payment is:
   - made to a person who is not carrying on a business;
   - made to a person who is carrying on a business, but the payment is not for that business;
   - a loan under the Small Business Cashflow Scheme or various research and development (R&D) related payments;
   - not in the nature of a grant or subsidy, for example, payments for services; or
   - not provided for deductible expenses or depreciable property, for example a payment:
     - provided to top up income (an income subsidy) as that is not provided for any expense and is subject to ordinary principles (usually taxable); or
     - for expenses that are not deductible (referred to as "black-hole expenditure").
6. However, in some situations it will not be clear how the grant provisions apply. This is where:
   - the payment is not for any specific expenditure;
   - the payment is not spent in the same year in which it is derived; or
   - there are surplus funds.
7. In these situations, the Commissioner considers:
   - The payment and the expenditure it funds must correspond to each other. This means the payment must be intended to be spent on deductible expenditure or depreciable property, but specific expenditure does not need to be identified. For example, where a business receives a payment for:
     - a specific expense, as long as the payment funds the specific expense and that expense is usually deductible to the business, the payment will correspond to the expense;

    - a capital asset, as long as the payment funds the asset and the asset is depreciable property, the payment will correspond to that asset; and
    - general operational expenses to use as it sees fit, as long as the payment funds the types of expenses that are usually deductible to the business, the payment will still correspond to the expense.
- The terms and conditions of a payment, or the fund from which the payment is made, will generally indicate whether it is provided for deductible or depreciable expenditure.
- A payment that is subject to the grant provisions is not taxable when it is derived. Generally, a payment is derived when a business can keep the payment. In some cases, however, payments may have conditions attached that mean a business does not derive the payment until those conditions are met. For example, a requirement to repay a payment if a condition is not met will mean the payment, or the part of it that is repayable, has not been derived.
- It does not matter if a payment is derived in one year but not spent until another year. The provisions apply provided corresponding deductible expenditure will be incurred. However, it is expected that the expenditure will be incurred within a reasonable timeframe.
- Deductions that correspond to the payment are denied to the extent they are funded by the payment. Similarly, the cost of depreciable property is reduced to the extent of the payment. Any expenditure incurred that exceeds the payment is still deductible. That is, where there is a shortfall in funding, the ordinary principles of deductibility apply to any additional expenditure used to meet that shortfall.
- The grant provisions operate on the basis that grants are to be tax neutral. Where the full payment is not spent on relevant expenditure, it is expected that the surplus is spent on other deductible expenses or depreciable property and deductions to the full extent of the payment are also denied.

8. The implications of these conclusions are as follows:
    - Many grant payments will be caught by the grant provisions and will be non-taxable and non-deductible.
    - Any payment for general or specific deductible expenses or depreciable property is not taxable when it is derived. An equivalent amount of deductions are denied when the expenses are incurred. The cost of an item of depreciable property is reduced by the amount of the payment and depreciation losses are calculated based on the reduced cost.[1] This treatment ensures tax neutrality of the payment.
    - If a payment is made to reimburse expenditure that was incurred in a prior year, a business may need to amend previous assessments to reverse out any deductions previously claimed.
9. The Commissioner expects businesses to spend any payments in accordance with their terms and within a reasonable time. Businesses must keep records to demonstrate the payment has been spent in their business and corresponding deductions, to the amount of the payment, have not been claimed.

Introduction | Whakataki

Overview of the grant provisions

10. Sections CX 47 and DF 1 contain the grant provisions. The provisions were introduced in 1973 to cater for grants available at that time. The wording of the provisions has changed over time. Uncertainty exists about how the grant provisions apply, particularly where the payment is not for any specific expenditure, is not spent in the same year in which it is derived, or where there are surplus funds.

Terms used and examples provided in this statement

11. In this Interpretation Statement, reference to a:
    - public authority includes a local authority and a PPCCC;
    - grant or payment includes a grant, subsidy and grant-related suspensory loan; and
    - deductible expense includes expenditure in the acquisition, construction, installation, or extension of an item of depreciable property
12. This statement provides examples to illustrate how the grant provisions apply. The examples do not reflect existing or previous grants or entities; they are illustrative only.

1 The reduction in cost will also affect other depreciation calculations that rely on the cost of an item of depreciable property.

Analysis | Tātari

13. Section CX 47(1) states:

> **Section CX 47 Government grants to businesses**
>
> *When this section applies*
>
> (1) This section applies when—
>
> (a) a local authority, public authority, or a public purpose Crown-controlled company makes a payment to a person for a business that the person carries on; and
>
> (b) the payment—
>
> (i) is in the nature of a grant or subsidy to the person; or
>
> (ii) is a grant-related suspensory loan to the person; and
>
> (c) the payment is not in the nature of an advance or loan other than a grant-related suspensory loan; and
>
> (d) the payment corresponds to—
>
> (i) expenditure that they incur and for which they would be allowed a deduction in the absence of section DF 1 (Government grants to businesses):
>
> (ii) expenditure that they incur in acquiring, constructing, installing, or extending an asset for which they would have an amount of depreciation loss in the absence of section DF 1

14. Subsections (1) and (1B) of s DF 1 state:

> **Section DF 1 Government grants to businesses**
>
> *When this section applies*
>
> (1) This section applies when—
>
> (a) a local authority, public authority, or a public purpose Crown-controlled company makes a payment to a person for a business that the person carries on; and
>
> (b) the payment—
>
> (i) is in the nature of a grant or subsidy to the person; or
>
> (ii) is a grant-related suspensory loan to the person; and
>
> (c) the payment is not in the nature of an advance or loan other than a grant-related suspensory loan; and
>
> (cb) the payment is not an amount of a loan under the small business cashflow scheme under section 7AA of the Tax Administration Act 1994; and
>
> (cc) the payment is not an amount of a loan made under the research and development loan scheme; and
>
> (d) the person does not make an election that section CX 47(4) (Government grants to businesses) apply to the payment.
>
> ...
>
> *When subsection (2) applies*
>
> (1B) Subsection (2) applies when, in the absence of this section, the person would be allowed a deduction for expenditure by the person to which the payment by the local authority, public authority or public purpose Crown-controlled company corresponds.

15. Both ss CX 47 and DF 1 apply where the:
    - payment is from a local authority, public authority or PPCCC;
    - payment is to a person for a business that the person carries on;
    - payment is in the nature of a grant or subsidy or is a grant-related suspensory loan; and
    - corresponding expense is one for which the business would be allowed a deduction if s DF 1 did not apply.
16. These four requirements are discussed in more detail in the following paragraphs.

17. Subsections (3) and (4) of s CX 47 set out payments not subject to the grant provisions:

> *Exclusions*
>
> (3) This section does not apply to a grant made under the Agriculture Recovery Programme for the Lower North Island and Eastern Bay of Plenty, to the extent to which the grant relates to expenditure—
>
> (a) incurred by the recipient before the grant; and
>
> (b) for which the recipient would be allowed a deduction in the absence of section DF 1.
>
> *Further exclusion*
>
> (4) A person may choose that this section not apply to a payment under a grant to the extent to which—
>
> (a) the grant is made to the person for the person's business as a research and development growth grant; and
>
> (b) the payment is withheld until the conditions of the grant are satisfied; and
>
> (c) in the absence of section DF 1, the person would be allowed for an income year before the income year of the payment,—
>
> (i) a deduction for expenditure to which the payment corresponds:
>
> (ii) depreciation loss resulting from expenditure to which the payment corresponds.
>
> *Another exclusion*
>
> (5) This section does not apply to an RDTI transition support payment

18. Section DF 1 also contains exclusions:

> *When this section applies*
>
> (1) This section applies when—
>
> ...
>
> (cb) the payment is not an amount of a loan under the small business cashflow scheme under section 7AA of the Tax Administration Act 1994; and
>
> (cc) the payment is not an amount of a loan made under the research and development loan scheme; and
>
> (d) the person does not make an election that section CX 47(4) (Government grants to businesses) apply to the payment.
>
> *When this section does not apply*
>
> (1BA) This section does not apply to the extent to which a payment described in subsection (1) is—
>
> (a) the payment of an R&D loss tax credit and the person's expenditure is attributable to that payment;
>
> (b) an RDTI transition support payment and the person's expenditure is attributable to that payment.

19. Some of the payments specified in the grant provisions are no longer available to businesses. For present purposes, the current payments specifically excluded from the grant provisions are:
    - loans under the Small Business Cashflow Scheme;
    - loans under the R&D Loan Scheme;
    - an R&D tax loss credit granted under subpart MX (see further "New legislation – Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016", *Tax Information Bulletin* Vol 28, No 3 (September 2016)); and
    - an R&D tax incentive transition support payment (see further "Amending the exclusion of expenditure related to a government grant", *Tax Information Bulletin* Vol 33, No 6 (July 2021): 79)[2]
20. These payments are covered by other legislative provisions.

2 R&D Growth Grants were also excluded from the grant provisions where the business elected, under s CX 47(4), to treat such payments as taxable income (see further "Consequential R&D amendments", *Tax Information Bulletin* Vol 23, No 1 (February 2011): 84). The R&D Growth Grants Scheme ended on 31 March 2021 and was replaced by the R&D tax incentive transition support payment.

Payment is from a local authority, public authority or PPCCC

21. The first requirement of the grant provisions (which are set out at [15]) is that the payment is from a local authority, public authority or PPCCC.
22. "Local authority" means a local authority as defined in s 5 of the Local Government Act 2002 and includes a regional council and territorial authority, which are also defined in that section. Section YA 1 also specifies entities that are local authorities.
23. A "public authority" means every department or instrument of the Executive Government of New Zealand and includes bodies set out in the definition in s YA 1.
24. A "PPCCC" means:
    - a company listed in schedule 35 (public purpose Crown-controlled companies); or
    - a company (the wholly-owned subsidiary) that has 100% of its shares owned directly or indirectly by a company listed in schedule 35 if the wholly-owned subsidiary's primary purpose is the carrying out of a public policy objective of the Government of New Zealand (s YA 1).
25. Payments from a local authority, public authority or PPCCC may sometimes be made through local organisations. For example, when grants are paid to businesses in specific regions following a localised event. In such cases, grant recipients should check who provided the funds to make the payment.
26. Example | Tauira 1 illustrates when a payment is not from the government.

Example | Tauira 1: Payment not from government

Following the temporary closure of the only road into a small rural town, a local Business Support Group, made up of local business owners, sets up a fund for affected businesses to assist with offsetting expenses while the road is closed. The local council contributes to the fund as do businesses outside the area and the general public.

Any payment from the fund will be from the Business Support Group, not the government, therefore the grant provisions will not apply to any payments.

Payment is made for a business that a person carries on

27. The second requirement of the grant provisions is that a local authority, public authority or PPCCC makes a payment to a person for a business that a person carries on.

Payment is made to a business

28. For tax purposes, an amount has been paid to a business when it has been distributed to it, credited to an account for it or dealt with in its interest or on its behalf (s YA 1, definition of "pay").
29. The payment must be made to a business. It is a question of fact whether a person is carrying on a business. A "business" is defined broadly in s YA 1 as including "any profession, trade, or undertaking carried on for profit".
30. The leading case on what constitutes a business is *Grieve v CIR* (1984) 6 NZTC 61,682 (CA). *Grieve* concerned a farming activity that, ultimately, did not generate any profits. The issue was whether the taxpayers were carrying on a farming business so they could claim deductions for losses incurred. The Court of Appeal held that whether a taxpayer is in business involves a two-fold inquiry as to the:
    - nature of the activities carried on; and
    - intention of the taxpayer in engaging in those activities.
31. In the leading judgment, Richardson J identified six factors relevant to determining whether a taxpayer is carrying on a business:
    - the nature of the activity;
    - the period over which the activity is engaged in;
    - the scale of operations and volume of transactions;
    - the commitment of time, money and effort;
    - the pattern of activity; and
    - financial results.

32. Richardson J also stated that it might be helpful to consider whether the operations involved are characteristic of that kind of business. However, ultimately, it is the character and circumstances of the particular venture that are crucial. Richardson J stated at [61,691]:

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

33. Therefore, whether a business exists is a question of fact in each case. However, a business must be in existence and the payment must be provided to the business itself for the grant provisions to apply. Example | Tauira 2 illustrates when a payment is not made for use in a business.

Example | Tauira 2: Payment not received by business

Zee owns a painting and decorating business and is known in the community for their artistic flair. Zee offers to donate their time to paint a mural at the local school. They apply for a grant for the art supplies from their local authority. The local authority makes the payment to Zee's business bank account.

Although the payment has been made to Zee's business account, it has not been paid to their business and is not for use in the business. Zee has received the grant in their capacity as a volunteer for use in a community project.

The payment is therefore not subject to the grant provisions.

Business must be carried on

34. A person starting up a business may not be in business when they receive a grant. The decision whether a business is being carried on is always one of fact and degree. Its resolution depends on the nature of the activities carried on and the taxpayer's intention in engaging in those activities (as set down in *Grieve*). A determination of the point at which a taxpayer makes a firm commitment to go into a business is critical for establishing the earliest time at which that business may have commenced. Commitment alone, however, is insufficient. The profit-making structure must also have been established and current operations must have begun to conclude that the business has commenced. For more information on when a business commences, see IS 17/01: *Income tax – deductibility of feasibility expenditure* (Interpretation Statement, Inland Revenue, Wellington, 2017).

Payment is in the nature of a grant or subsidy or a grant-related suspensory loan

35. The third requirement of the grant provisions is that the payment is in the nature of a grant or subsidy or a grant-related suspensory loan. The grant provisions do not define what a payment in the nature of a grant or subsidy is but there is relevant case law.

Grant or subsidy is a payment made without obligation

36. Case law has established that a payment in the nature of a grant or subsidy has one or more of the following characteristics:
    - it is paid gratuitously (without obligation) out of public funds by the Crown or another public body;
    - it is paid to further objectives in the public interest;
    - it is often made to public, charitable or private bodies to confer benefits on third parties; and
    - it is made to promote or encourage an industry or enterprise.
37. In deciding whether a payment is in the nature of a grant or subsidy, it is the character or quality of what is paid and of the consideration given that are crucial, not its receipt in the hands of the payee.[3]
38. For further information on the nature of a grant or subsidy, see:
    - Interpretation Statement "Treaty of Waitangi settlements: GST treatment", *Tax Information Bulletin* Vol 14, No 9 (September 2002): 50; and
    - Question We've Been Asked *GST Treatment of Funding Provided to Treaty of Waitangi Claimants by the Crown through the Office of Treaty Settlements* (Inland Revenue, Wellington, 2006).

3 See *Placer Development Ltd v Commonwealth of Australia* (1969) 121 CLR 353 (HCA), *First Provincial Building Society v FC of T* (1995) 95 ATC 4,145, *GTE Sylvania v R* [1974] CTC 751, *Reckitt & Coleman v FCT* 74 ATC 4,185, *Director General of Social Welfare v S & D De Morgan* (1996) 17 NZTC 12,636 and *Kena Kena Properties Ltd v A-G* (2002) 20 NZTC 17,433.

Grant-related suspensory loan is a grant in some cases

39. Government payments to businesses do not include payments in the nature of an advance or a loan. An "advance" is when money is handed over to someone before it is due.[4] A "loan" is an amount of money or a credit that a person lends or gives, whether or not that lending or giving is secured or evidenced in writing.[5]

40. However, the grant provisions do apply to a "grant-related suspensory loan" which is defined in s YA 1:

> **grant-related suspensory loan** means a loan—
>
> (a) that—
>
> (i) is made by a public authority; and
>
> (ii) is not a loan of the kind described in section CF 2(1) (Remission of specified suspensory loans); and
>
> (iii) includes the term that the liability of the borrower may be wholly or partly remitted; or
>
> (b) that is made by the Rural Banking and Finance Corporation of New Zealand as an irrigation suspensory loan and designated as such; or
>
> (c) that is made by the Rural Banking and Finance Corporation of New Zealand as a West Coast drainage suspensory loan and designated as such

41. Therefore, under s YA 1, a loan is a grant-related suspensory loan if it is made by a public authority (and is not designated as a specified suspensory loan by a public authority) and it:

- includes the term that the liability of the borrower may be wholly or partly remitted; or
- was granted by the Rural Banking and Finance Corporation of New Zealand (now ANZ Bank) as a West Coast drainage or irrigation suspensory loan.

Payment corresponds to deductible expenditure or depreciable property

42. The fourth requirement of the grant provisions is that the payment corresponds to deductible expenditure or depreciable property.

43. Subsection CX 47(1)(d) states:

> *When this section applies*
>
> (1) This section applies when—
>
> ...
>
> (d) the payment corresponds to—
>
> (i) expenditure that they incur and for which they would be allowed a deduction in the absence of section DF 1 (Government grants to businesses):
>
> (ii) expenditure that they incur in acquiring, constructing, installing, or extending an asset for which they would have an amount of depreciation loss in the absence of section DF 1.

44. Subsections (1B) and (3) of s DF 1 state:

> *When subsection (2) applies*
>
> (1B) Subsection (2) applies when, in the absence of this section, the person would be allowed a deduction for expenditure by the person to which the payment by the local authority, public authority or public purpose Crown-controlled company corresponds.
>
> ...
>
> *When subsection (4) applies*
>
> (3) Subsection (4) applies when—
>
> (a) expenditure by the person in the acquisition, construction, installation, or extension of an item of depreciable property is expenditure to which the payment by the local or public authority corresponds; and
>
> (b) in the absence of this section, the person would be allowed a deduction for an amount of depreciation loss for the item of depreciable property.

4 As defined in the *Concise Oxford English Dictionary* (12th ed rev, Oxford University Press, New York, 2011).

5 As defined in s YA 1.

45. These sections require that the:

    - payment and the expense correspond to each other, and
    - payment is for expenditure for which a business would be allowed a deduction.

Payment and expense correspond

46. The word "corresponds" is not defined in the Act. The *Concise Oxford English Dictionary* (12th ed rev, Oxford University Press, New York, 2011) defines "correspond" as having a close similarity, matching, agreeing almost exactly, or being analogous or equivalent.

47. In *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation (No 4)* [2015] FCA 1,092, the ordinary meaning of the word correspond was considered in the context of whether parts of two international tax treaties corresponded to each other. The Federal Court (at [562]) referred to the ordinary meaning of corresponds as "be similar or analogous, to be equivalent in function".

48. The ordinary meaning of the word corresponds must be considered in the context of the grant provisions and the purpose of those provisions (s 10 of the Legislation Act 2019). The word corresponds is used in both ss CX 47 and DF 1.

49. The ordinary meaning of the word corresponds indicates a similarity, matching or equivalence between two things. In the context of the grant provisions, this means there needs to be a similarity, matching or equivalence between a payment and a deductible expense. This is referred to as the necessary relationship (or nexus) between the payment and the expense. Uncertainty has existed about the scope of the relationship between the payment and the expense.

50. On one hand, it could be argued that the nexus between a payment and an expense is a narrow one. That is, for a payment to correspond to an expense, the payment must match a particular expense. This approach requires that the person providing the payment must specify what the payment is provided for, for example a payment for the purchase of a specific item of plant. Adopting a narrow nexus gives rise to issues about whether the provisions can be satisfied for payments that may be of a more general nature, for example a payment for general operational expenditure. Adopting a narrow nexus limits the scope of the grant provisions to only payments that are provided for specific expenses.

51. On the other hand, it could be argued that the nexus is a wide one. That is, for a payment to correspond to an expense, the payment must match only a more general (non-specified) expense, provided such general expenditure is ordinarily deductible. Under this view, a payment for general operational expenditure corresponds to any operational expense (which is ordinarily deductible) such as paying staff wages and vehicle maintenance costs.

52. The Commissioner considers that the grant provisions do not constrain the ordinary meaning of the word corresponds to a narrow nexus. There is no legislative requirement that a payment must be for a specific expense. The ordinary meaning of corresponds is wide enough to enable the wider view to be taken.

53. This means that where a payment is made for a business's general operating expenditure, that payment will be similar, analogous to or equivalent to any type of general operating expenditure that the business uses it for (as long as the expense is deductible). The same principle applies where a payment is made to fund unspecified capital expenses – as long as the item the payment funds is depreciable property and within the terms of the payment, the payment and the expense will correspond.

54. On balance, the Commissioner considers that the meaning of the word corresponds and the absence of anything in the provisions requiring a narrow interpretation to be taken, supports the view that the nexus between the payment and the expense in the grant provisions is a wide one. A wide nexus is available under the ordinary meaning of the word corresponds (as being something similar to or analogous). A wide nexus results in consistent tax treatment across a wider variety of government grants. When viewed in light of the intended purpose of the grant provisions, a wider nexus is consistent with the purpose of making government grants tax neutral.

55. Therefore, the Commissioner considers that a payment will correspond to deductible expenditure where the payment is either for a specific deductible expense (for example to help fund the purchase of a specific item of plant) or more general deductible expenditure (for example to help fund general operating expenses).

Payment is for expenditure for which a business would be allowed a deduction

56. The provisions require that either the expenditure is deductible or is on an item of depreciable property (for which a depreciation loss can be deducted). For a business to be allowed a deduction for an expense, the expense must first be incurred.

57. The requirement to incur an expense in order to claim a deduction is set out in the general permission in s DA 1. Under the general permission, a business can claim a deduction to the extent to which it is incurred by the business carrying on its business for the purpose of deriving its assessable and/or excluded income. Such expenditure is deductible under s DA 1, provided that none of the general limitations in s DA 2 applies.
58. Some business expenses, however, are not deductible as they are not incurred for the purpose of deriving income, for example payments to satisfy tax obligations or the payment of dividends to shareholders. Therefore, these types of payments do not fall within the grant provisions.
59. The capital limitation prevents expenditure of a capital nature being deductible under the general permission. However, s DA 4 permits a deduction for a depreciation loss for capital expenditure on depreciable property.
60. Other limitations in s DA 2, such as the private limitation, also prevent a deduction for an expense being claimed. These types of payments also do not fall within the provisions (although it seems unlikely that grant or subsidy payments would be given to a business for private expenses).
61. Subsection DF 1(7) states that s DF 1 overrides the general permission. This means s DF 1, not s DA 1, determines whether a deduction is allowed when the grant provisions apply.

Deductible expense can be incurred at any time

62. In terms of when the grant provisions require a deductible expense to be incurred, the relevant provision is subs CX 47(1)(d):

> (d) the payment corresponds to—
>
> (i) expenditure that they incur and for which they would be allowed a deduction in the absence of section DF 1 (Government grants to businesses):
>
> (ii) expenditure that they incur in acquiring, constructing, installing, or extending an asset for which they would have an amount of depreciation loss in the absence of section DF 1.

63. Subsection CX 47(1)(d) uses words that are present tense – "that they incur" rather than the past tense, which was previously used – "incurred". The section also refers to deductions in the future tense – "for which they would be allowed a deduction".
64. Case law indicates that little weight should be given to tenses used in legislation.[6] However, it can be argued that the change to the present and future tense in subs CX 47(1)(d) supports the view that there is no timing requirement for the incurrence of the expense in relation to the derivation of the payment. That is, the payment will correspond to an expense that a business incurs or will incur, whenever that time is. This change in tenses could relate to the fact that when the provisions were enacted, grants were paid under a reimbursement model. However, this is no longer the case and grants may be paid before or after an expense has been incurred.
65. While the tenses used in the grant provisions may not be persuasive in determining the correct interpretation of the provision, the tense changes (from "incurred" to "incur") are, in the Commissioner's view, relevant and could indicate the approach to be taken to determine when an expense needs to be incurred for the provisions to apply. The Commissioner also notes that, in recent years, there has been a move towards the use of the present tense in legislation for plain language reasons.
66. On balance, the Commissioner considers that the wording of s CX 47 does not restrict the incurrence of an expense to any particular time. The use of the present and future tense in the current provisions indicate the grant provisions do not require an expense to have already been incurred before a grant payment is made. That is, the wording of the section is broad enough to allow expenses to be incurred either before or after a payment has been made. This is consistent with the fact grants can be paid out before the relevant expense has been incurred. Adopting this interpretation results in consistent tax treatment across a wider variety of government grants.
67. In the Commissioner's view, while s DF 1 overrides the general permission, but not s CX 47, the two sections are intended to apply to the same payments (as set out at [15] and [19]). This means that if s CX 47 applies to payments for expenses that are yet to be incurred, s DF 1 applies to deny deductions in relation to the same payments when that expenditure is eventually incurred.

6 *Public Trustee v McKay (Minister of Health)* [1969] NZLR 995 (CA) and *R v Lewis* [1975] 2 NZLR 490.

68. The Commissioner, therefore, considers that the grant provisions can apply to payments that reimburse expenditure as well as payments for future expenditure. As long as the payment is for deductible or depreciable expenditure that the business has incurred or will incur at some point, the grant provisions will apply. Payments that are not for deductible expenditure or depreciable property are discussed at [72]–[75].
69. Accordingly, a grant will correspond to an expense when it is intended to fund deductible expenditure or depreciable property generally or specifically and the recipient business has incurred or will incur that expenditure at some point in time.
70. The terms or conditions of a grant or the parameters of the fund that provided the grant will generally indicate whether a grant was provided for deductible expenditure.
71. This means the grant terms do not have to specify an exact expense that the grant is provided for. Example | Tauira 3 illustrates how this approach applies to a payment for a specific expense, and Example | Tauira 4 illustrates how it applies to a payment for general expenditure.

Example | Tauira 3: Payment corresponds to a specific expense

In April 2021, the Kanapu local authority introduces a fund to help retain part-time hospital staff. Initiatives that help to retain such staff are eligible for a payment.

The Kanapu Centre provides childcare for staff who work at Kanapu Hospital. The centre wishes to extend its opening hours to provide childcare to staff working until 10pm.

In July 2021, the centre applies to the local authority fund for a $50,000 grant, stating it wants the money to help employ additional childcare staff. Better childcare services would help retain hospital staff.

In August 2021, the centre receives a payment from the fund and, in September 2021, successfully employs additional childcare staff.

Because the centre intends to use the payment to employ staff and the local authority provided the grant for that purpose, the payment and the expense correspond to each other. Therefore, assuming the whole payment is spent, the $50,000 payment is not taxable and $50,000 of the costs associated with employing additional staff is not deductible. Therefore, the total amount of staff wage costs, which would ordinarily be deductible, must be reduced by $50,000.

Example | Tauira 4: Payment corresponds to general expenditure

Trainmewell is a vocational training organisation providing training courses nationally. As a result of increasing demand, Trainmewell decides to build a purpose-built facility in Kettering to offer residential training courses.

In November 2021, when the new facility is opened, Kettering Regional Council gives Trainmewell $40,000 towards facility operating expenditure.

Trainmewell incurs operating expenditure of $300,000 during the year, including expenditure on employees, teaching materials, travel, electricity and insurance.

The payment is subject to the grant provisions because it was provided for general operating expenditure even though the council did not specify exactly what the payment was to be used for.

Trainmewell needs to retain records to demonstrate that operating expenditure of $40,000 has not been deducted in its tax return.

Income subsidies are taxable

72. A public authority, local authority or PPCCC may provide payments to businesses that are not for deductible expenditure or depreciable property, for example a subsidy paid to replace lost income or to supplement income.
73. Such payments do not correspond to a deductible expense, so do not satisfy the fourth requirement of the grant provisions. In these situations, the payment falls under ordinary tax principles. An income subsidy is usually taxable income to a business recipient.
74. Example | Tauira 5 illustrates a grant payment that does not correspond to deductible expenditure.

Example | Tauira 5: Payment does not correspond to a deductible expense

In October 2021, a bush fire breaks out in South Canterbury. It spreads across several farms, damaging crops and assets. In November 2021, the Government announces a subsidy for affected businesses to top up their income to make up for some of the income lost from being unable to harvest and sell their produce.

Hau's farm receives a subsidy of $15,000, and Hau later decides to put that money towards a new robot harvester (depreciable property) to replace the harvester destroyed by the fire.

Because the subsidy is provided to top up Hau's income and not for a deductible expense or depreciable property, the subsidy is not subject to the grant provisions. Therefore, the subsidy is taxable, being of an income nature under ordinary principles, and any depreciation loss for the harvester is determined under the ordinary deductibility rules.

Non-deductible expenditure is not subject to the grant provisions

75. A public authority, local authority or PPCCC may also make a payment to a business to subsidise business expenditure that is not ordinarily deductible or depreciable (sometimes known as "black-hole expenditure"). In that case, the payment does not correspond to deductible expenditure or depreciable property, so the grant provisions do not apply. Ordinary principles apply to the payment.

Unconditional payment is generally not taxable when it is derived

76. Section CX 47(2) states that, subject to certain exceptions, when a payment in the nature of a grant or subsidy is paid by a public authority to a business for deductible expenditure:

> *Excluded income*
>
> (2) The payment is excluded income of the person.

77. Subsection CX 47(2) does not state when the payment is to be treated as non-taxable, which could cause confusion as to how to treat the payment when it is received and spent in different income years. For example, it could be argued that the use of the word "payment" in s CX 47(2) means a grant becomes non-taxable when the payment is received. However, it could also be argued that, because the payment must correspond to an expense, the payment is taxable until it is spent (and then adjustments to past periods need to be made to treat past payments as non-taxable).

78. The Commissioner considers the payment becomes non-taxable when it is derived (and is not taxable regardless of whether it has been spent in the year of derivation). Under s BD 3, an amount is income at the time it is derived, unless a provision in any of parts C or E to I provides for allocation on another basis. Section CX 47(2) does not alter the time of derivation under ordinary principles or otherwise state that a payment is to be allocated on another basis. No other provisions in parts C or E to I apply to alter the time of derivation.

Payment is usually income when it is derived

79. The time of derivation of a grant payment is determined by case law in accordance with s BD 3(3). General principles from the case law on derivation are as follows:

- In relation to the derivation of income generally, the appropriate method for recognising income is the method that gives "a substantially correct reflex of the taxpayer's true income": *CT (SA) v Executor Trustee and Agency Company of South Australia Ltd* (1938) 63 CLR 108 at 154.
- In *Arthur Murray (NSW) Pty Ltd v FCT* (1965) 14 CLR 314, the High Court of Australia held that amounts paid for services in advance of the services being supplied did not constitute income derived until they were earned by the provision of the services for which the payment was made.
- In *Case N30* (1991) 13 NZTC 3,266 the Taxation Review Authority held that prepayments would be recognised as income at the time it became apparent that the recipient was no longer required to provide the services for which payment was made.
- In *CIR v Molloy* (1990) 12 NZTC 7,146, the High Court held that commissions advanced to an insurance agent did not have the quality of income earned and derived by the agent at the time they were received. This was because the commissions were not earned unless the insurance policy remained in force for two years.

80. Two general principles can be drawn from the above case law on the derivation of income:
    - A payment is not derived by a taxpayer until it is earned by the taxpayer providing the quid pro quo (for example, the services) for which it is paid.
    - The contingency that all or some part of the receipt might have to be repaid if the quid pro quo is not provided is relevant for determining whether the receipt has been derived.
81. For more information on when income is derived, see *Interpretation Statement* IS 16/06*: Income tax – timing – when is income from professional services derived?* (Interpretation Statement, Inland Revenue, Wellington, 2016).

Conditional payments may delay derivation

82. The principles in [76]–[80] are relevant to establishing the point at which a business derives income. These principles apply to all types of income, including payments that are subject to the grant provisions. If a payment has conditions attached, derivation occurs when the terms are satisfied such that the business can unconditionally keep the payment.
83. Some terms attached to a payment will not affect the time of derivation. For example, a business may be required to submit a report to a public authority to detail how it spent a payment from that authority. Unless failure to meet this condition means the payment, or part of it, has to be repaid, this term is likely to be more of an obligation than a condition of the payment. It is only where a payment, or part of it, has to be repaid if conditions are not met, that the time of derivation will be delayed. Generally, any funds that are required to be repaid because a condition of a payment has not been fulfilled are not derived by the business.
84. Example | Tauira 6 illustrates when a conditional grant is derived under ordinary principles.

Example | Tauira 6: Derivation of a conditional payment

In January 2022, the Government announced an apprenticeship scheme to encourage refugees to train as electricians and plumbers. The scheme will make a $5,000 payment to each business that employs a refugee as an apprentice and retains the apprentice for at least six months. The payment is made to participating businesses in increments every fortnight. At the end of the six-month period, if a business has retained the apprentice, it keeps the payment and derives the income at this point. If a business has not retained its apprentice, it cannot keep any of the payment and must repay it. In that case, the business will not have derived any part of the payment.

Deductions are denied when the expense is incurred

85. As noted at [62], s CX 47 applies to payments that correspond to expenditure that a business incurs. Once the corresponding expense is incurred by the business, s DF 1 then denies a deduction for that expense. The Commissioner expects a business will incur the relevant expenditure within a reasonable timeframe (which may, in some cases, also be part of the terms of the grant or subsidy).
86. Where an expense is incurred and the business has already claimed a deduction and a payment is subsequently provided to reimburse that cost, a business needs to amend earlier assessments to reverse out those previously claimed deductions. This requires the business to request an amendment to its earlier assessments under s 113 of the Tax Administration Act 1994.[7]

Amount of deduction denied is the amount of the payment

87. Subsections (2) and (4) of s DF 1 state that when the four requirements set out in [15] are met:

> *No deduction (with exception)*
>
> (2) The person is denied, to the extent of the amount of the payment, the deduction that they would have been allowed in the absence of this section.
>
> (3) …
>
> *Amount of depreciation loss*
>
> (4) For the purpose of quantifying the amount of depreciation loss, the amount of the expenditure is reduced by the amount of the payment.

7 The Commissioner would consider such requests under SPS 20/03, *Standard Practice Statement: Requests to amend assessments* (Inland Revenue, Wellington, 2020).

88. Section DF 1(2) denies the deduction "to the extent of the amount of the payment".

89. Section DF 1(4) reduces the amount of expenditure on an item of depreciable property (that is, the cost of acquiring, constructing, installing or extending the property) "by the amount of the payment". Any depreciation loss is then calculated on the reduced cost of the depreciable property.[8]

90. As with s CX 47, s DF 1 applies when a local authority, public authority or PPCCC makes a payment in the nature of a grant or subsidy to a person for a business that the person carries on. Therefore, the two provisions apply to the same type of payments. Although s DF 1 does not specifically refer to the payment being subject to s CX 47, the payment referred to is the grant or subsidy, so is the same "payment" that has been treated as non-taxable under s CX 47. This could be seen as a presumption that the whole payment is to be spent on relevant business expenditure. The wording of subss (2) and (4) shows an intention that it is the amount that has been treated as non-taxable under s CX 47 that is denied as a deduction.

Payment and expense must correspond to each other

91. The grant provisions also require that a payment and an expense correspond to each other. The meaning of the word "corresponds" in s CX 47 was discussed at [46]–[55]. As well as connecting the non-deductible expense to the non-taxable grant for the purposes of s CX 47, the word corresponds in s DF 1 is also used to specify the amount of the deduction that is denied. Nothing in s DF 1 indicates that the word corresponds should be given a different meaning.

92. Accordingly, because corresponds has the same meaning as in s CX 47, the word indicates a wide nexus can exist between the expenditure and the payment. This means the word corresponds in s DF 1 can apply to link any deductible or depreciable business expenditure to a payment. Therefore, the wording of s DF 1 is broad enough to link the payment to any deductible expenditure the payment is ultimately spent on, not necessarily just a specific expense the payment was provided for.

93. Once expenditure corresponds to the payment, subss (2) and (4) of s DF 1 then apply to deny a deduction or to reduce the cost of the item of depreciable property. Together, subss (2) and (4) indicate that the amount of the deduction to be denied, or the reduction of the cost base of the asset, is an amount equivalent to the whole payment.

94. As only the amount of the payment is denied under s DF 1, additional expenses are still deductible. For example, where a payment covers $9,000 of a $10,000 expense, the $9,000 is not deductible but the additional $1,000 is (as long as the expense is usually deductible). Example | Tauira 7 illustrates this point for deductible expenditure. Example | Tauira 8 illustrates the cost of depreciable property that is partly funded by a payment.

Example | Tauira 7: Deduction denied corresponds to the non-taxable payment

A business receives a grant of $30,000 to fund the wages of an apprentice. The business pays the apprentice $39,000 and reduces the deduction it takes for its wage bill for the year by $30,000. It treats the $30,000 grant as not taxable. The remaining amount of $9,000 is still deductible.

Provisions apply to surplus funds

95. As discussed at [87]–[94], under s DF 1, the amount of the deduction to be denied is equal to the amount of the payment received. Where an expense is greater than the amount of a payment received, a deduction is still allowed for any additional amount spent that exceeds the amount of the payment.

96. An issue that arises is how the provisions apply where there are surplus funds. That is, where a payment received exceeds the cost of the relevant expenses, and where the grantor does not require repayment of any surplus amount.

97. Where a non-specific grant payment is provided to a business (for example, a payment for general business expenses), the terms of the grant would cover any general expenses incurred by the business. Therefore, any business expense that is deductible will correspond to the payment (to the extent of the payment) and no surplus funds would arise. The issue regarding surplus funds arises only where the payment is provided for a specific expense.

98. As noted at [90], the wording of s DF 1 operates on the basis that the whole payment is disallowed as a deduction.

8 Where the depreciation regime refers to the cost of an item of depreciable property, the cost of the item will be reduced by the amount of the grant applied to it. For example, if an item of grant-funded depreciable property is later disposed of, the reduced cost base may affect whether any depreciation recovery income arises on disposal.

99. In the Commissioner's view, this means an amount equivalent to the whole payment received is denied as a deduction. In the case of a payment for a specific expense, where the expense is less than expected, there will be surplus funds from the payment. The Commissioner considers it likely that a business will spend those surplus funds on other expenses within its business, which are likely to be deductible to the business. In that case, where the surplus funds are applied to other deductible expenses or depreciable property, the Commissioner considers these expenses will still correspond to the payment, so are denied a deduction to the extent of the payment.

100. This approach is consistent with the wording used in s DF 1 that denies deductions to the extent of the amount of the payment. This approach is also consistent with the policy intent of tax neutrality. Example | Tauira 8 and Example | Tauira 9 illustrate this point.

Example | Tauira 8: Use of surplus funds within business

In mid-March 2022, the Kanapu Centre (from Example | Tauira 3) realises it has $3,000 left from the $50,000 grant payment it received from the Kanapu local authority for employing staff. The local authority does not require those funds to be repaid. As all the staff costs for the year have been met, and the centre needs to add additional play equipment to the playground, the centre uses the leftover funds on additional play equipment.

Although the local authority provided $50,000 specifically for staffing, only $47,000 was needed to meet staff costs. As the centre has used the surplus $3,000 on capital items for which a depreciation loss is deductible, the grant provisions apply to both the $47,000 of staff costs and the $3,000 capital expenditure. Therefore, the whole $50,000 is non-taxable income.

The Kanapu Centre should reduce its deductible wages expense for the year by $47,000.

The item(s) of play equipment that the surplus $3,000 was spent on should have their cost bases reduced by the same amount. For example:

Wooden Tower purchase price	$7,900
Minus surplus grants funds	($3,000)
Cost of item	$4,900

The Kanapu Centre can claim depreciation for the playground equipment using the cost base of $4,900.

Example | Tauira 9: Use of surplus funds within business

The mission of Hogo-solo Limited is to produce sustainable and affordable transport options for sole passengers. The company does not qualify for any R&D incentives but receives a $250,000 grant from the EcoTransport Fund (a public authority) towards its development of the Hogo, an electric-powered hoverboard with a seat. The Hogo is designed to transport only one passenger at a time and be used on- and off-road. The Hogo takes up less space than a car, requires no parking as it can be folded up and carried, and requires less energy than a car to produce and run.

The company finds it needs only $180,000 from EcoTransport to finish the Hogo's development, as private investors have already funded most of the development. The EcoTransport payment is not conditional and not repayable if it is not spent on development costs. Hogo-solo Limited splits the surplus $70,000 on other expenses - $30,000 for new crash test dummies (which are depreciable) for its other transport options and $40,000 to send its engineers to Europe to meet with their European counterparts to discuss new technology.

As the payment was provided to Hogo-solo Limited for use in its business on deductible or depreciable expenditure, it is non-taxable income to the company. Although it only spent $180,000 on developing the Hogo, the company spent the remainder of the funds on other expenditure, for which, in the absence of s DF 1, a deduction would be available. Therefore, under s DF 1, an amount to the value of $250,000 must be denied by Hogo-solo Limited in its business as follows:

- Hogo-solo prototype - reduce cost base, for depreciation purposes, by $180,000
- Crash-test dummies – reduce cost base, for depreciation purposes, by $30,000
- Overseas trip for engineers – reduce cost of trip by $40,000 (reduce deductions for trip by $40,000)

Business must keep records to show deductions are denied

101. A non-taxable grant does not need to be included in a business tax return, but businesses are required by s 15B of the Tax Administration Act 1994 to:
    - keep all necessary information (including books and records) and maintain all necessary accounts or balances required under the tax laws; and
    - disclose to the Commissioner in a timely and useful way all information (including books and records) that the tax laws require the taxpayer to disclose.
102. Accordingly, a business that receives a payment in the nature of a grant or subsidy from a public authority should keep appropriate records to demonstrate how the payment has been spent and that deductions to the amount of the payment have been denied. Businesses may also consider whether keeping the payment in a separate account may assist with record-keeping. Example | Tauira 10 illustrates how a small business might keep records. For more general information on record-keeping, *see IR1008: Record keeping – checklist* (Inland Revenue, Wellington, 2019).

Example | Tauira 10: Business must keep records

Naeem's Natty Nappies sells designer reusable nappies for the discerning baby. Naeem works from home in a small sleepout. An influencer promotes the Natty Nappies on their social media account, leading to a significant increase in business for Naeem.

Naeem applies for a grant of $10,000 from the local authority towards the rental of a unit from which to increase production. Naeem has only one bank account for all income and expenses (whether business or personal), and the grant is paid into that account.

Naeem struggles to keep track of their business income and expenses using the one account and asks an accountant for advice. The accountant advises Naeem to:

- open a second bank account and use that for the business so Naeem can keep track of their business income and expenses more easily
- download a copy of their bank statement every month into a spreadsheet, and
- highlight the $10,000 in the spreadsheet, noting the amount is a non-taxable grant and is to be used for rent.

Naeem follows this advice and now has a record of the grant payment and the corresponding expenses they cannot claim a deduction for.

Legislation | Whakature

103. Section CX 47 states:[9]

Section CX 47 Government grants to businesses

When this section applies

(1) This section applies when—

(a) a local authority, public authority, or a public purpose Crown-controlled company makes a payment to a person for a business that the person carries on; and

(b) the payment—

(i) is in the nature of a grant or subsidy to the person; or

(ii) is a grant-related suspensory loan to the person; and

(c) the payment is not in the nature of an advance or loan other than a grant-related suspensory loan; and

(d) the payment corresponds to—

(i) expenditure that they incur and for which they would be allowed a deduction in the absence of section DF 1 (Government grants to businesses):

(ii) expenditure that they incur in acquiring, constructing, installing, or extending an asset for which they would have an amount of depreciation loss in the absence of section DF 1.

Excluded income

(2) The payment is excluded income of the person.

Exclusions

(3) This section does not apply to a grant made under the Agriculture Recovery Programme for the Lower North Island and Eastern Bay of Plenty, to the extent to which the grant relates to expenditure—

(a) incurred by the recipient before the grant; and

(b) for which the recipient would be allowed a deduction in the absence of section DF 1.

Further exclusion

(4) A person may choose that this section not apply to a payment under a grant to the extent to which—

(a) the grant is made to the person for the person's business as a research and development growth grant; and

(b) the payment is withheld until the conditions of the grant are satisfied; and

(c) in the absence of section DF 1, the person would be allowed for an income year before the income year of the payment,—

(i) a deduction for expenditure to which the payment corresponds:

(ii) depreciation loss resulting from expenditure to which the payment corresponds.

Another exclusion

(5) This section does not apply to an RDTI transition support payment.

9 Sections CX 47 and DF 1 were amended by the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act (No 2) 2022 to include reference to PPCCCs with effect from 18 March 2019.

104. Section DF 1 states:

Section DF 1 Government grants to businesses

When this section applies

(1) This section applies when—

(a) a local authority, a public authority, or a public purpose Crown-controlled company makes a payment to a person for a business that the person carries on; and

(b) the payment—

(i) is in the nature of a grant or subsidy to the person; or

(ii) is a grant-related suspensory loan to the person; and

(c) the payment is not in the nature of an advance or loan other than a grant-related suspensory loan; and

(cb) the payment is not an amount of a loan under the small business cashflow scheme under section 7AA of the Tax Administration Act 1994; and

(cc) the payment is not an amount of a loan made under the research and development loan scheme; and

(d) the person does not make an election that section CX 47(4) (Government grants to businesses) apply to the payment.

When this section does not apply

(1BA) This section does not apply to the extent to which a payment described in subsection (1) is —

(a) the payment of an R&D loss tax credit and the person's expenditure is attributable to that payment;

(b) an RDTI transition support payment and the person's expenditure is attributable to that payment.

When subsection (2) applies

(1B) Subsection (2) applies when, in the absence of this section, the person would be allowed a deduction for expenditure by the person to which the payment by the local authority, public authority or a public purpose Crown-controlled company corresponds.

No deduction (with exception)

(2) The person is denied, to the extent of the amount of the payment, the deduction that they would have been allowed in the absence of this section.

When subsection (4) applies

(3) Subsection (4) applies when—

(a) expenditure by the person in the acquisition, construction, installation, or extension of an item of depreciable property is expenditure to which the payment by the local authority, public authority or a public purpose Crown-controlled company corresponds; and

(b) in the absence of this section, the person would be allowed a deduction for an amount of depreciation loss for the item of depreciable property.

Amount of depreciation loss

(4) For the purpose of quantifying the amount of depreciation loss, the amount of the expenditure is reduced by the amount of the payment.

Amendment of assessment

(5) Despite the time bar, the Commissioner may amend an assessment at any time in order to give effect to this section.

Exclusion [Repealed]

(6) {Repealed]

Link with subpart DA

(7) This section overrides the general permission.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Income Tax Act 2007, ss BD 3, CX 47, DA 1, DA 2, DA 4, DF 1, subpart MX, YA 1 ("business", "grant-related suspensory loan", "local authority", "pay", "public authority", "public purpose Crown-controlled company"), schedule 35

Legislation Act 2019, s 10

Local Government Act 2002, s 5 ("local authority", "regional council", "territorial authority")

Tax Administration Act 1994, ss 15B, 113

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IS 23/07: GST – Court awards and out-of-court settlements

This interpretation statement considers whether court awards and out-of-court settlements will be subject to GST. This may occur if the court award or settlement is consideration for a supply made by the person receiving the court award.

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

REPLACES | WHAKAKAPIA

- IS3387 "Interpretation Statement: GST treatment of court awards and out of court settlements", Tax Information Bulletin Vol 14, No 10 (October 2002): 21.

Introduction | Whakataki

1. Not all payments a registered person receives are subject to GST. GST is charged only if a supply of goods or services exists. Payment is relevant to the extent that the calculation of GST is based on the value of the supply.[1] The value of a supply is an amount calculated based on the consideration provided for the supply. Therefore, for a payment to be subject to GST, it must be consideration for a supply.
2. Some court awards or out-of-court settlements can involve payments that are consideration for a supply. The supply may be a new supply, for example where a court order or settlement involves a transfer of property in return for a payment, or an earlier supply, which may have been a subject of the dispute.
3. This interpretation statement discusses:
   - the requirement for a sufficient connection and reciprocity between a payment and a supply to exist (see from [21]);
   - how to determine whether a sufficient connection exists and, in particular, the need to consider the legal arrangements actually entered into (see from [31]);
   - the different types of court award or out-of-court settlement, including compensation for loss, awards based on restitution, a court order varying a contract by reducing the price of the goods, payments made on the alteration or termination of a contract, payments made for an agreement not to pursue further legal proceedings (a forbearance to sue), and payments made for a continuing wrong (see from [46]);
   - the effect of different GST accounting bases (see from [75]);
   - claiming GST input tax deductions in a later period (see from [81]);
   - the special case of payments received under a contract of insurance – where a registered person receives an amount from an insurer, the amount is deemed to be consideration for a supply made by the registered person (see from [83]); and
   - apportionment of a sum that is only partly in consideration for a taxable supply (see from [95]).
4. This statement does not discuss the application of s 20A(4) in detail. Briefly, s 20A(2) allows a taxpayer to claim an input tax deduction in relation to goods and services acquired for determining liability to tax. The section does this by deeming the goods and services to be acquired for making taxable supplies. If a taxpayer later receives an amount, whether by way of reimbursement, award of the court, recovery, or otherwise, in respect of the goods and services deemed to have been acquired, s 20A(4) deems the amount received to be consideration for a supply the person made in the course of a taxable activity in the taxable period in which it was received.

Requirements for charging GST

5. Whether a payment arising from a court award or an out-of-court settlement is subject to GST depends on whether the payment is consideration for a supply that is charged with tax under s 8.

1 Section 8(1).

6. Section 8(1) states:

> (1) Subject to this Act, a tax, to be known as goods and services tax, shall be charged in accordance with the provisions of this Act at the rate of 15% on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after 1 October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply.

7. For a supply to be charged with tax under s 8:
   - there must be a supply of goods or services;
   - the supply must not be an exempt supply;
   - the supply must be in New Zealand;
   - the supply must be made by a registered person; and
   - the supply must be made in the course or furtherance of a taxable activity carried on by the registered person.

8. If these requirements are satisfied, GST is charged on a supply by reference to the "value of the supply". The value of the supply is an amount that is calculated based on the "consideration" provided for the supply.[2] This interpretation statement does not consider the above requirements in detail; instead, it concentrates on whether a payment is consideration for a supply.

Consideration for a supply

Identifying a supply of goods or services

9. Not all payments a registered person receives in the course of their taxable activity will be consideration for a supply. GST is a transaction-based tax not a tax on receipts or turnover.[3]

10. To determine whether a payment is consideration for a supply, it is first necessary to identify a supply of goods or services.[4] If no supply exists, the payment is not consideration, so is not subject to GST. For example, a payment received as compensation for a loss does not involve a supply, so is not subject to GST.

11. "Supply" is defined generally in s 5(1) as including "all forms of supply". "Goods" is defined in s 2(1) as all kinds of personal or real property, but does not include choses in action, money, cryptocurrency or a product that is transmitted by means of a wire, cable, radio, optical or other electromagnetic system or by means of a similar technical system. "Services" is defined in s 2(1) as anything that is not goods or money or cryptocurrency.

12. Although the definitions of goods and services are together very wide, it is still necessary for a supply of something to have occurred.[5]

13. No supply exists if goods are stolen or taken without permission or if a person uses goods without right, even if a payment is subsequently made in respect of the wrongdoing.[6] Any payment subsequently paid for the goods is in the nature of compensation, not consideration for the goods.

14. However, a mandatory acquisition of property under legislation can be a supply, as the transaction is accompanied by a legal transfer of ownership.[7]

15. An agreement not to do something in the future can be a supply. For example, a candy manufacturer may reach a settlement agreement with a bakery nearby, not to use noisy sugar-crushing equipment between 10am and 11am on Monday to Friday. This would be a supply of a chose in action, which is a service.

16. A forbearance to sue as a supply is discussed from [65].

2 Section 10. The value of the supply is the amount that, with the addition of GST, is equal to the consideration for the supply. For example, if the consideration provided for a supply is $115 and the GST component is $15, the value of the supply is $100.

3 *CIR v Databank Systems Ltd* [1989] 1 NZLR 422 (CA).

4 However, in special cases a payment may be deemed to be consideration for a deemed supply, in which case it is not necessary to identify a supply. An example of this arises in relation to payments received from insurers, which is discussed at [85].

5 *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075 (CA) at 15,081.

6 *Bank of New Zealand v Waewaepa Station 2002 Ltd* [2013] NZHC 3,321.

7 See "QB 13/03: Goods and services tax – Whether a compulsory acquisition of land is a 'supply by way of sale'", *Tax Information Bulletin* Vol 25, No 7 (August 2013): 97.

Situations involving a set off of two amounts

17. Often court awards or out-of-court settlements situations will involve payment obligations going each way and an agreement may be made to set off the payment obligations. Set off merely provides a mechanism for satisfying two payment obligations. The effect of a set off is the same as if an amount were paid by one party and then handed back by the other. Set off does not change the amounts of the underlying payment obligations.[8] This is illustrated in Example | Tauira 1.

Example | Tauira 1 – Compensation for loss and set off

Truck Seller sells trucks with attached freezer units. Ice Cream Seller purchases a truck for $100,000 so it can deliver orders of ice cream. Ice Cream Seller pays $75,000 upfront, with the remaining $25,000 due in one month.

The truck is delivered and functions well at first. However, after two-weeks use, the freezer unit on the truck is found to be faulty. An ice cream order is lost as a result.

Ice Cream Seller takes Truck Seller to court claiming damages of $30,000 for the loss. The judge awards the full amount claimed.

Truck Seller and Ice Cream Seller agree to set off the $30,000 court award against the $25,000 balance owed by Ice Cream Seller on the truck. Truck Seller then pays the $5,000 difference to Ice Cream Seller.

The only cash transfers that have been made are the initial payment of $75,000 by Ice Cream Seller to Truck Seller and the $5,000 payment by Truck Seller to Ice Cream Seller. However, for GST purposes, Ice Cream Seller has still provided consideration of $100,000 for the truck. Truck seller's GST output tax, and Ice Cream Seller's input tax deduction, will be calculated based on consideration of $100,000, not $75,000.

The set off has the same effect as if Truck Seller paid Ice Cream Seller $30,000, and Ice Cream Seller then paid Truck Seller the $25,000 owing on the truck.

The payment of the $30,000 court award has no GST consequences because it is compensation for a loss, not consideration for a supply (see [49]).

Definition of consideration

18. As noted above, GST is charged on a supply by reference to the "value of the supply". The value of the supply is an amount calculated based on the "consideration" provided for the supply.

19. Consideration is defined in s 2(1):

> **consideration**, in relation to the supply of goods and services to any person, includes any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services, whether by that person or by any other person; but does not include any payment made by any person as an unconditional gift to any non-profit body

20. Five points to note from the definition are as follows:
    - Consideration can be in the form of a payment or an action or forbearance (agreement not to exercise a right). Consideration can also be in money or money's worth.[9] This is illustrated in Example | Tauira 5, variation 1b. However, for ease of reference, this statement mostly limits discussion to payments of money.
    - A voluntary payment can be consideration.
    - To be consideration, a payment must be made "in respect of, in response to, or for the inducement of", a supply.
    - To be consideration, a payment does not need to be made by the recipient of the supply.
    - A payment made as an unconditional gift to a non-profit body is not consideration.

8 *FCT v Steeves Agnew and Co (Vic) Pty Ltd* (1951) 82 CLR 408.

9 See s 10(2).

Sufficient connection and reciprocity

21. The courts have held that the definition of consideration extends the ordinary contract law meaning.[10] However, in *Taupo Ika Nui Body Corporate v CIR*,[11] Gallen J stated that although the statutory definition of consideration in the Act was wider than the contract law meaning, the definition did not remove the contract law requirement for an element of reciprocity to be present within a transaction in order for the payment to be "consideration" for a supply:

> The question arises therefore, whether the definition is so worded that there is no need for an element of reciprocity. With some hesitation I have come to the conclusion it does not. The use of the term "consideration" imports the specialised meaning given to that term in a legal context, which would tell against a meaning involving a mere handling of the funds.

22. In *Chatham Islands*,[12] the Court of Appeal identified the need for a linkage or connection and the need for reciprocity in establishing this. Tipping J noted at [30]:

> When coupled with the definitions of taxable activity and consideration, to which I shall come, and in spite of the width of those definitions, the concept of supplying services has a reciprocal connotation…

23. In *Chatham Islands*, the issue was the GST treatment of payments made to the Chatham Islands Enterprise Trust by the New Zealand Government. The payments were made for the purpose of carrying out the objects of the trust, which were related to the development of the Chatham Islands. The payments allowed the trust to provide, for its beneficiaries, services that were previously the responsibility of the Government. The Commissioner argued that the payments were consideration as they induced the trust to carry out its functions, and that this was a supply of services to the Crown. In the alternative, the Commissioner argued that the supplies were made by the trust to its beneficiaries.

24. In the judgment of Keith and Blanchard JJ (delivered by Blanchard J), Blanchard J noted at [18] that the trust had not assumed a contractual or even a voluntary obligation to the Government. The Government had merely vested money in trust for the people of the Chatham Islands:

25. Similarly, in a separate judgment, Tipping J stated that the concept of supplying services has a reciprocal connotation. The fulfilment by the trustees of their duties as trustees did not have a reciprocal connection to the payments made by the Crown.

26. The need for a sufficient connection to exist between a payment and a supply was also emphasised in *New Zealand Refining*[13]. Blanchard J stated at 13,193 that to constitute consideration for supply a payment must be made for that supply. He also stated that there is a practical necessity for a sufficient connection between the payment and the supply.

27. *New Zealand Refining* involved payments the Government made to a taxpayer who was the owner of an oil refinery. The Government had previously given the taxpayer certain assurances in relation to money the taxpayer borrowed to expand the refinery. With the deregulation of the oil industry, the Government and the taxpayer reached an agreement to end the assurances. The payments were made as part of that agreement. It was a condition of the payments that the refinery remain operational on each payment date.

28. In that case, the Commissioner argued that the words "in respect of, in response to, or for the inducement of" meant the consideration had an extremely wide definition. The Commissioner argued that the relevant supplies were the supplies the taxpayer refinery made to its customers (to be consideration for a supply, a payment does not need to be made by the recipient of the supply). The Commissioner argued that, given the wide definition of consideration, the payments the Government made were sufficiently linked to the supplies the taxpayer made to its customers.

29. However, the Court of Appeal held that the connection between those supplies and the payments made by the Government was insufficient. This was because the payments were not dependant on such supplies being made. To qualify for the payments, the refinery simply had to be operational. The necessary element of reciprocity was absent.

30. Tenuous and unrealistic connections between a supply and a payment are not sufficient for the payment to be regarded as consideration for the supply.[14]

10 *The Trustee, Executors and Agency Co NZ Ltd v CIR* (1997) 18 NZTC 13,076 (HC) at 13,085.

11 (1997) 18 NZTC 13,147 (HC) at 13,150.

12 See footnote 5.

13 *CIR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 (CA).

14 *CIR v Suzuki* (2000) 19 NZTC 15,819 at 15,831.

Determining whether a sufficient connection exists

31. When determining whether a sufficient connection exists between a payment and a supply, it is necessary to consider the legal arrangements actually entered into, not the economic or other consequences of the arrangements.[15]

Label used is not determinative

32. The label attached to a payment is not determinative of its legal nature.

33. It might be expected that the label used by a court to describe a payment would accurately reflect the legal nature of the payment. However, it may not be necessary for a court to specify the basis for a payment. This might occur where, for example, there are alternatives bases on which an award could be ordered, and the basis selected does not affect the amount of the award.

34. Therefore, in determining the legal nature of a payment it may be necessary to consider the circumstances of the dispute. In the case of out-of-court settlements, it is necessary to consider the remedy that would most likely have resulted had the dispute proceeded to court. This is illustrated in Example | Tauira 2.

Example | Tauira 2 – Label used for payment is not determinative

A courier driver is keen to expand his operation by purchasing another van and employing a driver. The courier driver finds a suitable van that another courier (the seller) is selling and enters into a contract to purchase the van, paying a deposit of $5,000. The courier driver agrees to take possession of the van the following month. In the meantime, the seller provides taxable supply information (previously a "tax invoice") for the sale and the courier driver (who accounts for GST on the invoice basis) claims an input tax deduction for the van.

However, the seller contacts the courier driver with some bad news: the van has been repossessed, so the seller is unable to provide the van.

Not knowing quite what to do to unwind the transaction, the courier driver writes a settlement agreement based on an example a friend has used in the past and presents it to the seller. The seller signs the agreement and pays the delivery driver $5,500.

The settlement agreement describes the $5,500 payment to the courier driver as compensation for the loss suffered by the courier driver.

Despite being labelled as compensation for a loss, $5,000 of the settlement payment should be treated as a refund of the deposit paid by the courier driver. This is because there has been a total failure[16] by the seller to perform his obligation under the contract. In this situation, the normal remedy would be for a court to order a refund of the deposit. The remaining $500 likely represents a payment for a loss, given that the courier driver was likely inconvenienced by the seller's failure to deliver the van.

The settlement results in the cancellation of the supply. Therefore, an adjustment is required under s 25. The seller must provide supply correction information (previously a "credit note") detailing the adjustment. The courier driver needs to return output tax in his next return, effectively reversing the input tax deduction claimed on the purchase of the van (in relation to the $5,000 deposit). If the seller had returned GST on the supply of the van, the seller would be able to claim an input tax deduction on the cancellation of the supply. The remaining $500 of the payment does not have any GST consequences.

Payment does not need to be made under a contract

35. To be consideration, a payment does not need to be made under a contract, provided the consideration is in respect of, in response to, or for the inducement of, the supply.[17]

15 *New Zealand Refining*. See also *Marac Life Assurance Ltd v CIR* [1986] 1 NZLR 694 (CA) at 706, *CIR v Gulf Harbour Development Ltd* (2004) 21 NZTC 18,915 (CA) and *Rotorua Regional Airport Ltd v CIR* (2010) 24 NZTC 23,979 (HC).

16 See *Laws of New Zealand* Restitution: Doctrine of total failure of consideration (LexisNexis, online edition, 2022) at [44] (accessed 17 March 2023).

17 *Turakina Maori Girls College Board of Trustees v CIR and Canterbury Jockey Club Inc v CIR* (2018) 28 NZTC 23,074 (HC).

36. An award of *quantum meruit* is an example of a type of award that can be consideration for a supply, despite the absence of a contract. An award of *quantum meruit* can be made where the recipient has provided something for the payer's benefit, but where there is no contractual remedy for them to pursue to receive payment. *Quantum meruit* is a generic term used to identify a right to a reasonable remuneration for goods or services that are supplied.[18] Often an award of this nature is made where a contract is silent as to the price of goods or services or where a supply of something has occurred on the assumption a contract would eventuate. With this type of awards, a sufficient connection with a supply will generally exist. The payment will be ordered because of the goods or services that have been supplied and the supply will usually have been made with an expectation of receiving payment. This is illustrated in Example | Tauira 3.

Example | Tauira 3 – Absence of a contract is not determinative

A GST registered carpenter hears that a business is interested in commissioning a new boardroom table from timber recovered from the business's old premises. The carpenter puts together a proposal including concept drawings and hardware and joinery options. The business likes the design and asks the carpenter to proceed.

The carpenter purchases the hardware required for the table, takes possession of the timber and stores the timber for two months so it can acclimatise to the humidity in the carpenter's workshop.

However, before the first cut is made the business cancels the order. The carpenter returns the timber to the business and retains the hardware for another job, but due to the limited space in his workshop he charges the business a fee to cover the storage of the timber. The business refuses to pay the fee as no contract was entered into.

The Disputes Tribunal decides that despite no table being produced, the carpenter has provided a benefit to the business by storing the timber for two months. The tribunal decides it is reasonable for the carpenter to charge a fee for the storage and makes an award requiring the business to pay the fee. Based on the tribunal's reason for the award, a sufficient connection exists between the award and a supply (of timber storage) for the award to be consideration for the supply. Therefore, the award is subject to GST. The absence of a contract does not prevent the award from being consideration.

The result would have been different if the carpenter had instead sought and received compensation for a loss arising from not being able to do other projects because of the lack of space.

Legally enforceable obligations do not need to exist

37. Similarly, for a payment to be consideration for a supply, legally enforceable obligations do not need to exist between the parties.

38. This is illustrated by *Case 8/2018*,[19] which involved payments parents made to a taxpayer who operated a private school. The parents made the payments voluntarily and not pursuant to any contractual obligation. The taxpayer argued that for a payment to be consideration, reciprocal obligations must be "enforceable at law" and cited *Chatham Islands* in support of this proposition. However, Judge Sinclair held that the court in *Chatham Islands* did not find or impose any requirement that the required reciprocity must be evidenced by reciprocal obligations enforceable at law. Judge Sinclair held that Blanchard J's statement in *Chatham Islands* (that the payments were not made pursuant to any covenant by the Crown involving reciprocal obligations by the trust enforceable at law) was simply a factual finding. Judge Sinclair noted that a voluntary payment can be consideration, and a voluntary obligation is, by its nature, not legally enforceable.

Adjustments to consideration

39. Section 25 requires adjustments to be made to the GST treatment of earlier supplies in certain circumstances.[20] Of particular relevance to court awards and out-of-court settlements, adjustments are required where taxable supply information, or a tax position taken in a return, for an earlier supply contains an incorrect amount of consideration.

40. A court award could result in an incorrect amount of consideration if the court award changes the consideration for a supply. Whether a court award has the effect of changing the consideration for a supply involves the same test that applies when determining whether a payment is consideration for a supply; that is, the payment the court orders must have a sufficient connection with the supply and involve reciprocity.

18 *Seton Contracting Ltd v AG* [1982] 2 NZLR 368 (HC) at 376.

19 (2018) 28 NZTC 4,015 (TRA).

20 Section 25 applies where the original supply was made by a registered person. See also ss 25AA and 25AB, which apply to imported goods and services and secondhand goods.

41. An example of a court award that will change the consideration for a supply and create an inaccuracy that needs to be adjusted under s 25, is an order under s 43(3)(c) of the Fair Trading Act 1986 varying a contract by reducing the price of the goods.[21] Such an order might be made if the quality of goods purchased is misrepresented. This is illustrated in Example | Tauira 4, Scenario 2.
42. A court award could be related to the consideration for a supply without actually changing the consideration. A good example of this can be seen in *Montgomerie v CIR*.[22] In that case, following a company's liquidation, the liquidator required creditors to return payments the creditors had received for supplies they had made to the company.[23] The facts, at first sight, appear to suggest an adjustment to the consideration for the supply. However, the Court of Appeal held that recoveries from the creditors were not an adjustment to the consideration for the supplies. The payments were not made because the parties to the supply had agreed to adjust the consideration, nor did the Companies Act 1993 characterise the payments as an adjustment to the consideration. The creditors still retained the right to pursue payment for the supplies under the liquidation. The repayment was made in the context of a liquidation where amounts are sometimes recovered from creditors so other creditors can also receive a share of the available funds. For tax purposes, this did not alter the fact of the supply or the consideration for the supply.
43. Depending on the adjustment, s 25 may require the supplier and recipient to account for additional output tax or allow an input tax deduction to ensure the correct amounts of GST are returned or claimed.
44. Where a court award changes the consideration for a supply, the supplier may also need to issue "supply correction information"[24] to the recipient of the supply under s 19N.
45. However, a recipient should not wait for the supply correction information before making an adjustment. Where a recipient is required to return an amount of output tax as a result of an adjustment under s 25, the output tax is attributed to the taxable period in which the supply correction information is issued or the recipient becomes aware of the excess. In the context of a court award or out-of-court settlement, the parties will generally become aware of the inaccuracy when the order is given or settlement is reached. This is before the supply correction information is issued (and, potentially, in an earlier taxable period).

Different claims and remedies

46. Disputes can involve variety of different claims and remedies. These may result in different GST treatment depending on whether the legal nature of the remedy suggests a sufficient connection between a payment and a supply. This is illustrated in Example | Tauira 4.

Restitution and compensation for loss

47. Two different bases on which a court order might be made are compensation for loss and restitution.
48. Where an award is based on compensation for loss, the assessment is of a sum that will put the person who has suffered a loss in the same position as they would have been in had the relevant breach or wrong not occurred.[25]
49. Compensation for a loss is not consideration for a supply because a person does not make a supply by suffering a loss.
50. Even if an award is related to a supply and is calculated based on the amount of consideration provided for the supply, the award will not have any GST consequences if it is compensation for a loss.
51. The GST treatment of compensation for a loss is illustrated in Example | Tauira 4, scenario 1.
52. Where an award is based on restitution, the goal is to deprive the defendant of a gain which they have received at the expense of the plaintiff and which it would be unjust for them to retain.[26] This will often require the defendant to restore to the plaintiff what has been wrongly taken or, if that is not possible or practicable, order a payment of a monetary equivalent of the thing that was taken.[27]

21 Not all orders made under the Fair Trading Act 1986 involve adjustments to the consideration for a supply. For example, compensation orders under s 43(3)(f) do not involve adjustments to consideration.

22 (2000) 19 NZTC 15,569.

23 Under ss 292 and 294 of the Companies Act 1993.

24 Previously referred to in the legislation as a "debit note" or "credit note".

25 *Gardiner v Metcalfe* [1994] 2 NZLR 8 (CA).

26 *Laws of New Zealand*: Restitution (LexisNexis, online edition, 2022) at [1] accessed 27 June 2023.

27 *Equiticorp Industries Group v The Crown* [1996] 3 NZLR 586 (HC).

53. Restitution is a complicated area of law and many types of restitutionary remedy exist. However, generally, the Commissioner's view is that where a monetary equivalent is paid in restitution to a person from whom a thing has been taken without justification, the payment is not consideration for a supply of the thing. Reciprocity is lacking in this situation. The payment of a monetary equivalent is not made because the thing has been supplied, rather it is made because it is not possible or practicable to return the thing and it would be unconscionable to allow the person to retain the benefit of the thing. This is illustrated in Example | Tauira 5.

54. Other types of restitutionary remedy may involve a supply and the required reciprocity, for example an award in *quantum meruit* (see [36]).

55. In a proceeding involving a breach of contract, the ordinary remedy at common law is not the return of part of the purchase price, but damages to compensate the innocent party for the breach. An exception is if there is a total failure of consideration by the other party, which may result in the cancellation of the supply.[28] In the latter case, consideration paid for the supply needs to be refunded and the adjustment rules in s 25 apply.

56. *Case S77* specifically considered whether an amount paid as compensation for a loss could be consideration for a supply subject to GST.[29] The taxpayers were a farming couple registered for GST. A fire they lit on their farm spread to a neighbouring farm and caused substantial damage. This led to allegations of negligence that resulted in an out-of-court settlement. The taxpayers sought an input tax credit on the amount they paid under the settlement. The Commissioner disallowed this credit on the basis that the recipient of the payment had not made a supply in return for the payment. Judge Barber held that the situation did not involve the supply of any goods and services to the taxpayers, as the payment was made on account of a loss.

57. In *Case N62*,[30] the taxpayer leased scaffolding equipment from another company, and some was lost. The taxpayer paid an amount to the scaffolding company under a settlement agreement and claimed an input tax deduction for the payment. The Commissioner argued that the taxpayer was not entitled to the deduction because the payment related to a debt security.

58. *Case N62* was concluded by agreement between the parties rather than by a decision by the Taxation Review Authority. The case was also a relatively early case on GST decided before cases such as *New Zealand Refining* and *Chatham Islands*, where the need for reciprocity was emphasised. Therefore, the case is of limited authority. However, the Taxation Review Authority made the comment:

> After this matter had proceeded for a time, I suggested to counsel that the concept of "debt security" did not appear to me to relate to the facts of this case; that **there must have been a supply of goods and services** from the other company to the objector; that the consideration for such a supply must be the value of the settlement (and any monies paid previously) … [Emphasis added]

59. The Taxation Review Authority did not need to give any detailed reasoning for its comment that there must have been a supply. From the facts of the case, it is not possible to determine what the legal basis for the payment was.

60. In the Commissioner's view, *Case N62* is not authority for a general proposition that a payment to a lessor for the loss of leased property is consideration for the supply of rights in the property. To determine whether a payment is consideration for a supply, it is necessary to have regard to the legal arrangement in any particular case. However, unless some contrary indication arises from the particular legal arrangement, a payment for the loss of leased property appears to be compensation for a loss suffered by the lessor, so not subject to GST. A payment by a lessee to a lessor for lost lease property would generally be made because of the inability to return the leased property and the subsequent loss suffered by the lessor, not because of any transfer of ownership in the property. It is not sufficient that the payment arises as a result of the lease of the equipment (which was a supply). Reciprocity is lacking between a lease supply and a payment for lost leased property; such a payment is not made for the lease of the property.

28 *Coxhead v Newmans Tours Ltd* (1993) 6 TCLR 1 (CA).

29 (1996) 17 NZTC 7,483 (TRA).

30 *Case N62* (1991) 13 NZTC 3,480 (TRA).

Example | Tauira 4 – Different legal basis can affect GST treatment

A restaurant owner purchases a pizza oven for $3,000 (including GST), which the retailer claims is of commercial quality, so suitable for high use situations such as commercial catering operations. However, after using the oven during service, the restaurant owner finds the oven cannot reach and maintain the required heat for continual use.

The restaurant owner is unsuccessful in her attempts to persuade the retailer to replace the oven or provide a refund of the purchase price.

Scenario 1

The restaurant owner brings the case to court, claiming general damages, as she has suffered a loss in receiving goods of lesser quality than she paid for. The judge agrees and orders the retailer to pay the restaurant owner $2,000.

The $2,000 is compensation for the restaurant owner's loss in receiving goods of poor quality. Although a supply exists that relates to the award, the connection between the court award and the supply of the pizza oven is insufficient for the court award to be an adjustment to the consideration for the supply. This is because the court award relates to losses suffered rather than consideration for the supply of the oven. Therefore, no adjustment is made to the GST charged on the supply of the oven, and the GST output tax returned by the retailer and the input tax claimed by the restaurant owner are unaffected. There is also no other supply the award might relate to. Therefore, no GST consequences arise from the award.

Scenario 2

The restaurant owner brings the case to court, claiming the retailer made a misrepresentation about the power output of the oven, the materials it was made of and its suitability for restaurant use. The judge agrees and orders the retailer to pay $2,000 to the restaurant owner as a partial refund of the purchase price. The judge makes this order under s 43(3)(c) of the Fair Trading Act 1986.

A sufficient connection exists between the court-ordered refund and the supply of the pizza oven. As a result, adjustments may be required to the consideration for the supply.

Both the retailer and the restaurant owner had already accounted for the $391.30 of GST charged on the supply in their previous GST returns. For the purposes s 25(1) of the Act, there is now an "inaccuracy" (arising from an incorrect amount of consideration and tax charged) on the taxable supply information (tax invoice) that was issued by the retailer. The correct GST on the supply is only $130.43, with the excess GST being $260.87.

Both the retailer and the restaurant owner need to adjust their tax returns:

- The retailer can make a deduction under s 20(3) for $260.87 in its return for the taxable period in which the inaccuracy became apparent (the period in which the court order was made);[31]
- The restaurant owner must return output tax of $260.87 in its return for the taxable period in which the inaccuracy became apparent (the period in which the court order was made).[32] The restaurant owner will be aware of the excess GST on receiving news of the court order. The restaurant owner should not wait to receive supply correction information from the retailer.

31 Section 25(2)(b).

32 Section 25(4).

Example | Tauira 5 – Payment received when property taken without justification

Happy Go Lucky Builders is building a house next door to a construction project Sensible Construction is working on. A delivery of timber is made to the street and Happy Go Lucky Builders uses the timber to construct framing, without checking that the delivery was for it, which it wasn't.

After realising the error and engaging in negotiation, the parties agree it isn't practicable to return the timber, Happy Go Lucky Builders agrees to pay Sensible Construction an amount for the timber in full and final settlement of the matter.

Variation 1a

Sensible Construction decides the simplest solution is to offer to sell the timber to Happy Go Lucky Builders and Happy Go Lucky Builders accepts this offer. Under this option, there is a supply that is subject to GST. Sensible Construction will issue an invoice for an amount including GST.

Variation 1b

Happy Go Lucky Builders remembers that it had made an order for timber, which is due to arrive in a couple of days (coincidentally the order is of the same size as it took from Sensible Construction). Happy Go Lucky Builders and Sensible Construction agree that this timber order can be assigned to Sensible Construction as payment for the timber Sensible Construction agreed to sell to Happy Go Lucky Builders. This saves Sensible Construction from having to make a new order.

This arrangement involves two supplies: a supply of timber by Sensible Construction and a supply of timber by Happy Go Lucky Builders. The assignment of the timber order by Happy Go Lucky Builders is consideration for the supply by Sensible Construction and vice versa. This variation illustrates that consideration can be in money's worth.

Variation 2

Sensible Construction makes a claim for an award based in restitution and the Disputes Tribunal grants the award. The tribunal's decision results in Sensible Construction agreeing not to seek the return of the timber and allows Happy Go Lucky Builders to pass on good title to the timber as part of the house. However, the court award does not result in a supply of rights in the timber from Sensible Construction to Happy Go Lucky Builders. The timber was taken without right. Even if there were a supply, reciprocity between the court award and the supply would, arguably, be lacking. The court award, based on restitution, is not made for the timber, but rather because it was not practicable to restore the timber to Sensible Construction.

Payment on the alteration or termination of a contract

61. Where one party terminates an ongoing supply contract without a right to terminate and without the agreement of the other party, a settlement sum in respect of this action will typically relate to a loss that the other party suffers as a result of the early termination. In this situation, there is no supply by the other party of their rights under the contract because they did not agree to the termination and no other legal mechanism suggests a supply.
62. A settlement agreement will usually also involve an agreement not to pursue further legal proceedings (referred to as a forbearance to sue). As discussed later in this statement from [65], such an agreement can be a supply, but generally the settlement sum will be for the underlying loss, not a forbearance. As compensation for a loss, the settlement sum will not be subject to GST.
63. In contrast, where one party to a contract obtains the other party's agreement to alter or terminate the contract in exchange for a payment, there is a supply by that other party of rights under the contract, and the payment is consideration for the supply.
64. This is illustrated in Example | Tauira 6.

Example | Tauira 6 – Termination of a contract

A supplier of goods has a five-year, $5 million contract with a customer, to make regular supplies of a fixed number of items. The contract runs smoothly for three years, when all of a sudden, the customer informs the supplier it is no longer willing to accept the contracted supply.

As the contract is extremely valuable to the ongoing viability of the supplier's business, the supplier informs the customer it will pursue its contractual rights to the fullest extent of the law.

The customer still refuses to perform its side of the contract in accepting the items, and the supplier files a claim in court for $2 million.

The customer decides it would be sensible to offer a compromise sum as an out-of-court settlement, offering the supplier $1.5 million to avoid the court case. The supplier accepts and agrees not to pursue court proceedings as a condition of the settlement.

The circumstances suggest the payment relates to the loss of revenue and damage to the viability of the supplier's business that will result from the termination. Therefore, the payment is not consideration for any supply.

Variation

If the customer had instead reached an agreement with the supplier for the early termination of the contract in consideration for a payment of $1.5 million, then the payment would have been consideration for a supply. The difference in this variation is that there would be a supply of rights under the contract by the supplier to the customer.

Agreement not to pursue further legal proceedings

65. A settlement agreement usually includes an agreement by the parties not to pursue further legal proceedings. This is sometimes referred to as a forbearance to sue.

66. The question of whether a forbearance to sue can be a supply was considered in *Case S77* and *Case T22*.[33] In *Case S77*, the Taxation Review Authority stated at 7,487:

> In my view no taxable supply was made between the parties. The objectors paid money to the L partnership (an exempt supply of a financial service) and **the latter accepted it in full settlement of their damages claim and agreed to take no further enforcement steps** and have the then court proceedings struck out. That does not seem to me to involve a supply of any good or service from the L partnership to the objectors. All that has passed between the objectors and the L partners physically is the payment or handing over of a cheque. **In the abstract, all that has passed between them is the surrendering by the L partners of their right to proceed with their claim against the objectors. That surrender is not a supply. The L partnership has not forgone any legal right or anything else – it has achieved enforcement of its legal right to damages**. It merely ceased the legal recovery mechanism provided for the enforcement of legal rights… [Emphasis added]

67. In *Case S77*, the Taxation Review Authority made the point that the agreement by the L partnership (the party who suffered the loss) not to take further enforcement steps did not involve the partnership forgoing any legal right. This is because the partnership had achieved enforcement of its legal rights through the settlement payment. The payment was fully attributable to the underlying loss, not to the surrender of a particular enforcement mechanism.

68. In *Case T22*, the Commissioner tried to argue that the payment was consideration for the taxpayer refraining from suing the Crown. The Commissioner was actually precluded from relying on this ground as it was not a ground relied on in its assessment of the taxpayer that was the subject of the objection. Nevertheless, as an obiter comment, the Taxation Review Authority stated that the taxpayer's forbearance to sue was not a supply of a service. The Crown may have considered that it derived some benefit from the taxpayer's decision not to exercise those rights, but that did not convert the taxpayer's decision into a provision of services to the Crown.

69. Although, the Taxation Review Authority suggested that the forbearance to sue was not a supply, the Commissioner's view is that a forbearance to sue is capable of being a supply (given the wide definition of supply), but a settlement payment is generally for something other than the forbearance. The forbearance to sue is generally incidental to the resolution of the underlying dispute and merely a mechanism to ensure finality in the dispute. Therefore, generally, no part of the settlement payment will be attributable to the forbearance.

33 (1997) 18 NZTC 8,124 (TRA).

70. However, sometimes, the facts may suggest that part of a settlement payment is consideration for the forbearance to sue. Relevant factors in this regard might include the:
    - attribution of part of the payment to the forbearance under the settlement agreement;
    - extent to which the total payment cannot be attributed to other matters, for example compensation for loss;
    - risk of reputational damage from court action;
    - risk of costs being awarded against the defendant; and
    - strength of the plaintiff's claim and their willingness to take the case.
71. This is illustrated in Example | Tauira 7.

Example | Tauira 7 – Agreement not to sue

An advisor and a client are both GST registered. The advisor causes the client to lose thousands of dollars as a direct result of the client relying on negligent business advice the advisor provided.

The client believes he has a solid case to take to court, but the advisor persuades the client to settle out of court.

Scenario 1

The parties agree to a settlement under which the advisor pays $10,000 to the client for the loss suffered. Under the settlement, the client accepts the payment in "full and final settlement" of his claim against the advisor, which means the client agrees not to sue the advisor.

The payment has no GST consequences because the payment is compensation for a loss. The agreement not to sue is merely a mechanism to ensure finality in the dispute so no part of the consideration is attributable to the agreement not to sue.

Scenario 2

The parties agree to a settlement under which the advisor pays $15,000 to the client. The client accepts the payment in "full and final settlement" of his claim against the advisor.

The settlement agreement specifies that $10,000 of the payment is compensation for the client's loss and $5,000 is consideration for agreeing not to take the claim to court.

The $10,000 attributed to compensation for the client's loss has no GST consequences. However, the agreement not to sue is a supply and the $5,000 is consideration for that supply. Further, the supply is a taxable supply as it was made in course or furtherance of the client's taxable activity. Therefore, the client must return output tax on the supply ($5,000 – ($5,000/(1+0.15)) = $652.17), and the advisor can claim a corresponding input tax deduction.

Payment awarded for continuing wrong

72. Under s 13 of the Senior Courts Act 2016, the High Court can award damages for a continuing wrong (including an infringement of property rights) instead of granting an injunction. In substance, a continuing infringement of property rights can appear similar to a supply of those property rights, and damages can appear similar to consideration for a supply of those property rights. However, in determining the GST treatment of a payment it is necessary to have regard to the legal arrangements actually entered into, not the economic or other consequences of what has occurred. Property rights are not supplied merely because a court refuses to grant an injunction preventing the continued infringement of the rights. Therefore, a payment of damages awarded instead of granting an injunction, is not consideration for a supply.
73. This is illustrated in Example | Tauira 8.
74. The involuntariness aspect might invite comparison between a payment awarded for a continuing wrong and a payment received in compensation for the compulsory acquisition of land (which is treated as consideration for a supply and potentially subject to GST).[34] However, these situations are distinguishable because, as noted above, with a payment awarded for a continuing wrong, no property rights are transferred. With a compulsory acquisition of land, the land is legally transferred, so there can be a supply.

34 See QB 13/03.

Example | Tauira 8 – Payment for continuing wrong

A council constructs a sewer pipe on private property without the property owner's permission. The owner takes the case to court and requests removal of the pipe.

The court refuses to order removal of the pipe, but it does exercise its power under s 13 of the Senior Courts Act 2016 to award damages. The amount of the damages is calculated by reference to the amount the owner could reasonably expect if the council had agreed to pay for the use of the land.

The council payment to the owner is not consideration for any supply.

It might be argued that the award in this example is consideration for a supply because it is related to the use of the land. However, the owner has not supplied any property rights to the council. The owner still has the relevant property rights, but they are being infringed by the continued presence of the sewer pipe. The court has merely refused to give the owner a remedy (injunction) that will stop the infringement. The damages are awarded instead of an injunction and compensate the owner for the continued infringement of the property rights.

The fact damages are calculated by reference to the amount the owner could reasonably expect if the council had agreed to pay for the use of the land, does not mean this is what the payment is for.

Accounting basis

75. The GST consequences of a court award or out-of-court settlement that is consideration for a supply depends on whether the supplier or recipient account for GST on an invoice basis or a payments basis.
76. If the supplier accounts for GST on an invoice basis and receives a court award or out-of-court settlement, the supplier will likely already have returned the GST following the issue of an invoice for the supply. If so, receipt of the payment will not trigger any further GST implications.
77. If the supplier accounts for GST on a payments basis, receipt of the payment may trigger liability for GST.
78. If the recipient of a supply accounts for GST on an invoice basis, an input tax deduction may have already been claimed when the invoice was received. However, given that the payment for the supply may have been in dispute, in practice the recipient might not have claimed a deduction on receiving the invoice. In this case, it may be possible to claim a deduction in a later period (discussed further from [81]).
79. If the recipient of a supply accounts for GST on a payments basis, the receipt of a court award or out-of-court settlement may trigger the ability to claim a deduction for the period in which the amount is received.
80. This is illustrated in Example | Tauira 9.

Claiming a deduction in a later taxable period

81. If the recipient of a supply has not claimed an input tax deduction in the relevant period (the period in which the time of supply occurs), in some limited circumstances, set out in the proviso to s 20(3), the recipient can claim a deduction in a later period. This is discussed in QB 09/04,[35] which deals with the relationship between s 113 of the Tax Administration Act 1994 and the proviso. Briefly, the item finds the following:
    - Without qualification, a deduction can be made in a later period that begins within a defined two-year period. This two-year period begins on either the date the invoice is issued or the date the payment is made, whichever is earlier. For example, a registered person with a two-monthly filing frequency could claim an input tax deduction in the GST return for the taxable period ended 31 March 2025 (which begins on 1 February 2025) if the invoice for the supply was issued on or after 1 February 2023.[36]

35 "QB 09/04: The relationship between section 113 of the Tax Administration Act 1994 and the proviso to section 20(3) of the Goods and Services Tax Act 1985 when a registered person has not claimed an input tax deduction in an earlier taxable period", *Tax Information Bulletin* Vol 21, No 6 (August 2009): 53.

36 Again, assuming payment was made after the invoice was issued.

- A deduction can also be made in a later taxable period (with no time restriction) where the registered person's failure to make the deduction in the earlier taxable period arises from:
  - the recipient's inability to obtain taxable supply information (previously "a tax invoice");
  - a dispute over the proper amount of the payment for the taxable supply to which the deduction relates;
  - the recipient's mistaken understanding that the supply was not a taxable supply; or
  - a clear mistake or simple oversight by the recipient.

82. This is illustrated in Example | Tauira 9.

Example | Tauira 9 – Claiming a deduction in a later period

A contractor takes her van to a mechanic for repairs. The mechanic carries out repairs and the contractor collects the van and returns to work. After a few days, the contractor observes a new fault. The contractor believes the mechanic caused the new fault. The mechanic disagrees and invoices the contractor $1,150 including GST for the repairs. However, the contractor refuses to pay the invoice.

After failing to resolve the dispute, the mechanic takes the contractor to the Disputes Tribunal. The mechanic is able to prove that the new fault is unrelated to the repairs, and the contractor agrees to pay the amount invoiced.

The invoice for $1,150 was issued on 2 February 2022. The agreement at the Disputes Tribunal is reached on 23 November 2022 and payment of $1,150 is made on the same day.

The mechanic accounts for GST on the invoice basis, and the contractor accounts for GST on the payments basis. Both have a two-monthly payment frequency with the same end dates.

GST treatment

In their returns for the period ended 31 March 2022, the:

- mechanic needs to account for $150 of GST on the supply of repair services invoiced to the contractor; and
- contractor cannot claim an input tax deduction because she has not made any payment and accounts for GST on the payments basis.

In their returns for the period ended 30 November 2022, the:

- mechanic does not need to do anything in relation to the supply as they have already returned GST on the supply in the March return; and
- contractor can claim an input tax deduction of $150 because she made the payment in the November period.

Variation

Same facts as above, but the contractor accounts for GST on the invoice basis rather than the payments basis. Also, the contractor did not claim an input tax deduction in the March period because she intended to dispute the fee.

Despite the supply relating to the March period and, in this variation, accounting for GST on an invoice basis, the contractor can claim the input tax deduction in the November period because the:

- November period began before the two-year anniversary of the invoice being issued for the supply; and/or
- failure to claim the input tax deduction in the March period was due to a dispute over the proper amount of the payment for the supply.

Payments received under a contract of insurance

83. A specific rule in s 5(13) may apply to payments received under a contract of insurance.

84. The requirements of the rule in s 5(13) are discussed below. Where a payment is received by a registered person under a contract of insurance, and the requirements of s 5(13) are satisfied, the payment is **deemed** to be consideration for a supply made by the person in the course or furtherance of the person's taxable activity.

85. Under s 5(13), it is not necessary for an actual supply to occur or to establish that a sufficient connection or reciprocity exists between the payment from the insurer and a supply. This means payments that would otherwise not be subject to GST (for example, a payment made as compensation for a loss) can be subject to GST if the payment is made under a contract of insurance.

86. For s 5(13) to apply:
    - a registered person must receive a payment;
    - the payment must be made under a contract of insurance; and
    - the payment must relate to a loss incurred in the course or furtherance of the registered person's taxable activity (the section applies to the extent the payment is related to such a loss).

87. Section 5(13) does not apply if any of the following are true:
    - The supply of the contract of insurance is not a supply charged with tax under s 8(1). For example, tax will not be charged if the supply of the contract of insurance was not made "in New Zealand" because the insurer is not resident in New Zealand (and the insurer does not choose to treat the supply as made in New Zealand) (see s 8(3)(c) and (4D)).[37]
    - The payment is in respect of an entitlement for any loss of "earnings", being earnings within the meaning of the accident compensation acts listed in s 5(13).[38] The meaning given under those acts is too detailed to fully discuss in this statement. However, without being exhaustive and with some exclusions, "earnings" under the accident compensation acts can include amounts earned as an employee, a self-employed person or as a shareholder employee.
    - The supply of the contract of insurance is a supply of remote services that is zero-rated under s 11A(1)(x) as a result of a decision by the supplier to treat the supply as made in New Zealand under s 8(4D).
    - The supply of the contract of insurance is a supply that is chargeable with tax only because ss 5B and 8(4B) apply to it (these provisions apply to a supply of remote services by a non-resident where it is estimated or determined that the percentage intended use or percentage actual use of the supply of insurance for making taxable supplies is less than 95%).

88. The registered person to whom s 5(13) applies does not need to be party to the contract of insurance. The section applies to a registered person who receives a payment under a contract of insurance "whether or not the person is a party to the contract". Therefore, the section can apply, for example, where the insurer pays an amount directly to a third party as a result of damage caused by the person insured under the contract of insurance. In such a case, assuming the other requirements of s 5(13) are met, the Commissioner's view is that the thirdparty must return GST on receipt of that payment.

89. A payment is made by an insurer "under" a contract of insurance where there is a disagreement between the insurer and the insured person about the insurer's liability under the contract and the insurer makes a payment in settlement of the dispute, whether or not the insurer admits liability under the contract.

90. Section 5(13) applies to a registered person who "receives" a payment. Under a wide interpretation of "receive" it could be argued that the person insured under a contract of insurance "receives" a payment when an amount is paid by an insurer to a third party that discharges a liability owed by the insured person to the third party (sometimes described as a constructive payment). However, in the context of s 5(13), it is considered that "receives" does not include a constructive payment. A constructive payment interpretation would be inconsistent with the section specifically stating that the

37 Often, particularly in larger settlement payments, there may be several insurers involved in a claim. For each insurer there is a separate supply of insurance services. The recipient of a payment from multiple insurers will need to determine how much is received from each insurer and whether the supply from each insurer is subject to GST under s 8, which will depend on the residence of the insurer and, if non-resident, whether the insurer has chosen to treat the supply as made in New Zealand.

38 Including the Accident Compensation Act 2001 and predecessor legislation: Accident Compensation Act 1982, the Accident Rehabilitation and Compensation Insurance Act 1992 and the Accident Insurance Act 1998.

section applies to an amount received by a registered person under a contract of insurance "whether or not the person is a party to the contract".

91. An insurance payment may be paid into the trust account of a solicitor before being paid to the person who has suffered the loss, for example. This might be the solicitor acting for the party who is making the settlement payment or the solicitor acting for the person who has suffered the loss. If an insurance payment is made this way, the party who has the GST obligation under s 5(13) is the party into whose solicitor's trust account the insurance payment is made. This is because s 5(13) applies to the registered person who receives the insurance payout. A solicitor in this context receives the insurance payment as agent for their client, so the client is treated as receiving the payment.
92. Sometimes, it might not be clear to the recipient of a payment that the payment is made by an insurer under a contract of insurance. An insurer may not admit any liability under the insurance contract until the facts of the dispute become more apparent. Even when the facts of the dispute become clearer and the insurer determines that they have, or may have, a liability, they may not wish to disclose their involvement as doing so might influence a plaintiff's expectations about the size of a settlement.
93. Third-parties who are seeking a remedy from a person, should seek clarification during negotiations with the person to understand whether a payment will be made by an insurer under a contract of insurance and, therefore, whether the amount received will be subject to GST as a result of s 5(13).
94. See CS 20/01 for the Commissioner's operational position on this topic.[39]

Apportionment of a sum that is only partly in consideration for a taxable supply

95. In some cases, a payment can be made for more than one thing. Part of the payment may relate to a taxable supply and the remainder of the payment to something else. The part of the payment that is not attributable to a taxable supply could be attributable to an exempt supply or it may not relate to a supply at all.[40]
96. Section 10(18) provides that where a taxable supply is not the only matter to which a payment relates, the supply shall be deemed to be for the part of the payment that is properly attributable to the supply.
97. "Properly attributable" is not defined in the Act, so takes its ordinary meaning. "Properly" in this context appears to mean in an appropriate or suitable manner.[41]
98. In *Auckland Institute of Studies Ltd v CIR*,[42] the High Court discussed how to determine what part of a payment is properly attributable to supply. The court noted that other parts of the Act, including ss 4(2) and 10(2)(b), indicate that the open market value of the supply is an appropriate basis on which to fix value. The court also suggested that values could initially be assessed on the basis of the actual cost of providing the separate supply, plus a reasonable allowance for profit (a "cost plus" approach). However, the court stated that, ultimately, the appropriate value for a separate supply would have to be tested against the market. The court accepted the argument for the Commissioner that the value of a separate supply could not exceed the sum a hypothetical consumer would be prepared to pay.
99. It may be appropriate to attribute a global sum on a prorated basis between the various matters to which the global sum relates, if valuations of the various matters total an amount different to the global sum received.
100. Where multiple elements are supplied with potentially different GST treatments, the parties may also need to determine whether they have a single composite supply (of all the elements) with a single GST treatment, or multiple separate supplies with different GST treatments. See IS 18/04 "Interpretation Statement Goods and services tax – Single supply or multiple supplies", *Tax Information Bulletin* Vol 30, No 10 (November 2018): 5.
101. This is illustrated in Example | Tauira 10.

39 "CS 20/01: GST liability for insurance and settlement payments to third party claimants – Section 5(13) of the Goods and Services Tax Act 1985", *Tax Information Bulletin* Vol 32, No 2 (March 2020): 7.

40 *CIR v Coveney* (1994) 16 NZTC 11,328 (CA).

41 *Oxford English Dictionary* (Oxford University Press, online version, 2022, accessed 31 January 2023).

42 (2002) 20 NZTC 17,685 (HC).

Example | Tauira 10 – Apportionment of global settlement amount

A patent owner has a patent for a lucrative product. For three years business is booming, with global exports increasing every year. However, in the subsequent two years business suddenly drops, and export volumes are only 20% of the earlier volumes. The patent owner finds out from a local contact that for the past two years a competitor has been using the technology patented by the patent owner to create and sell an almost identical product. The patent owner has ample evidence of the unauthorised use of the patent and informs the competitor that a court case is imminent. The competitor accepts it has made wrongful use of the patent and is prepared to compensate the patent owner.

During discussions, the patent owner also agrees to sell the patent rights to the competitor.

The parties agree to a global sum of $150,000 in settlement of the wrongful use of the patent and to transfer the patent rights to the competitor.

This payment needs to be apportioned between the compensation for the loss suffered and the consideration for the supply of the patent rights. After considering the matter more carefully, the patent owner calculates that their losses arising from the wrongful use of the patent are $120,000 and the value of the patent is $60,000.

Based on these values, the appropriate apportionment, on a prorated basis, is to attribute $100,000 of the settlement payment to compensation and $50,000 to consideration for the supply of the patent rights. The patent owner must return output tax on the supply of the patent rights by reference to the consideration of $50,000, and the competitor can claim a corresponding input tax deduction.

Whether a person has suffered the cost of GST as part of their loss

102. When a person is claiming compensation for a loss they have suffered, it is worthwhile considering whether their loss includes GST. If a person has suffered loss or damage to property and they need to replace or repair the property, the replacement or repair costs may be subject to GST. If the costs are subject to GST, and the person cannot claim a deduction for the GST (for example, if they are not registered for GST), then they bear the cost of the GST and it is part of the loss they have suffered. If the person can claim a deduction for GST, then GST is not part of the loss they have suffered.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Companies Act 1993, ss 292, 294

Fair Trading Act 1986, s 43(3)(c)

Goods and Services Tax Act 1985, ss 2(1) ("consideration", "goods", "services"), 4(2), 5(1) ("supply"), 5(13), 5B, 8, 10, 11A(1)(x), 19N, 20A, 20(3) proviso, 25, 25AA, 25AB

Senior Courts Act 2016, s 13

Tax Administration Act 1994, s 113

Case references | Tohutoro kēhi

Auckland Institute of Studies Ltd v CIR (2002) 20 NZTC 17,685 (HC)

Bank of New Zealand v Waewaepa Station 2002 Ltd [2013] NZHC 3,321

Canterbury Jockey Club Inc v CIR (2018) 28 NZTC 23-074 (HC)

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

Case N62 (1991) 13 NZTC 3,480 (TRA)

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CIR v Databank Systems Ltd [1989] 1 NZLR 422 (CA)

CIR v Gulf Harbour Development Ltd (2004) 21 NZTC 18,915 (CA)

CIR v New Zealand Refining Co Ltd (1997) 18 NZTC 13,187 (CA)

CIR v Suzuki (2000) 19 NZTC 15,819 (HC)

Coxhead v Newmans Tours Ltd (1993) 6 TCLR 1 (CA)

Equiticorp Industries Group v The Crown [1996] 3 NZLR 586 (HC)

FCT v Steeves Agnew and Co (Vic) Pty Ltd (1951) 82 CLR 408 (HCA).

Gardiner v Metcalfe [1994] 2 NZLR 8 (CA)

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The Trustee, Executors and Agency Co NZ Ltd v CIR (1997) 18 NZTC 13,076 (HC)

Turakina Maori Girls College Board of Trustees v CIR (1993) 15 NZTC 10,032 (CA)

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TECHNICAL DECISION SUMMARY

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 23/08: GST input tax deductions and output tax liability

Decision date | Rā o te Whakatau: 16 March 2023

Issue date | Rā Tuku: 16 June 2023

Subjects | Kaupapa

Goods and Services Tax: Whether the Taxpayer was eligible to claim input tax deductions. Whether the Taxpayer was liable for output tax. Whether the Taxpayer was liable for shortfall penalties.

Taxation laws | Ture tāke

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

Facts | Meka

1. The Taxpayer is a company and provided accounting and tax advisory services to clients.
2. Customer and Compliance Services, Inland Revenue (CCS) sought to disallow input tax deductions claimed by the Taxpayer relating to goods and services provided to it in connection with client matters where the clients were removed from the New Zealand register of companies (Companies Register) when the Taxpayer worked on their matters.
3. CCS also sought to disallow input tax deductions claimed for goods and services for which the Taxpayer did not hold the required tax invoices and for goods and services provided to it in relation to a property that it leased.
4. In addition, CCS claimed that an amount the Taxpayer had received was consideration for a taxable supply in respect of which it was accountable for output tax.
5. CCS sought to impose shortfall penalties for gross carelessness or, alternatively, not taking reasonable care, in either case reduced by 50% for previous behaviour.
6. The Taxpayer did not accept the proposed adjustments by CCS and the matter was referred to the Tax Counsel Office for adjudication.

Issues | Take

7. The main issues considered in this dispute were:
   - Whether the Taxpayer was entitled to the disputed input tax deductions;
   - Whether the Taxpayer was liable for output tax in relation to an amount it received;
   - Whether the Taxpayer is liable for shortfall penalties for gross carelessness or, alternatively, shortfall penalties for not taking reasonable care, in either case reduced by 50% for previous behaviour;
   - Whether the Commissioner is time barred from amending the Taxpayer's assessment for the taxable period ended 30 September 2018.
8. There was also a preliminary issue on the onus and standard of proof.

Decisions | Whakatau

9. TCO decided:
   - The Taxpayer was not entitled to any disputed input tax deductions for which it had failed to show it held the required tax invoices. These include disputed input tax deductions for which tax invoices had been provided, but the invoices did not show the Taxpayer as the recipient of the supply.
   - The Taxpayer was not entitled to disputed input tax deductions relating to goods and services provided to it in connection with client matters where the clients were removed from the New Zealand register of companies (Companies Register) when the Taxpayer worked on their matters.
   - The Taxpayer was entitled to disputed input tax deductions to the extent they related to goods and services provided to it in connection with client matters where the clients were on the Companies Register when the Taxpayer worked on their matters, and where it held the required tax invoices or tax invoices were not required because the supplies were made for $50 or less.
   - The Taxpayer was not entitled to disputed input tax deductions relating to goods and services provided to it in connection with a property it leased.
   - The Taxpayer was liable for output tax on an amount it received.
   - The Taxpayer was liable for shortfall penalties for gross carelessness, reduced by 50% for previous behaviour.
   - The Commissioner is not time barred from amending the Taxpayer's GST assessment for the taxable period ended 30 September 2018.

Reasons for decisions | Pūnga o ngā whakatau

Preliminary issue | Take tōmua: Onus and Standard of Proof

Onus of proof

10. The onus of proof in civil proceedings[1] is on the taxpayer, except for shortfall penalties for evasion or similar act, or obstruction.[2] The taxpayer must prove that an assessment is wrong, why it is wrong, and by how much it is wrong.[3]

Standard of proof

11. The standard of proof in civil proceedings is the balance of probabilities.[4] This standard is met if it is proved that a matter is more probable than not.

Issue 1 | Take tuatahi: Input tax

12. This issue concerns whether the Taxpayer was entitled to the disputed input tax deductions. CCS argued that the input tax deductions were not allowed because the Taxpayer did not acquire the goods and services to which the input tax deductions relate or use them in making taxable supplies. The Taxpayer argued that it acquired the goods and services and used them in making taxable supplies.
13. For a GST registered person to deduct GST input tax:
    - They must have acquired the goods and services to which the input tax relates.
    - The goods and services must have been used for, or available for use in, making taxable supplies.
    - Tax invoice requirements must have been met.
14. These requirements are cumulative; to deduct input tax all of them must be met. They are strict requirements.[5]

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

2 Section 149A(2) of the TAA.

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

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

5 *Case 1/2012* (2012) 25 NZTC 1-013.

15. TCO concluded that the Taxpayer was not entitled to any disputed input tax deductions for which it has failed to show it held the required tax invoices because input tax deductions cannot be made where the required tax invoices are not held.
16. The Taxpayer's entitlement to input tax deductions relating to goods and services provided to it in connection with client matters differed depending on whether the clients were companies removed from, or on, the Companies Register when the Taxpayer worked on their matters.
17. The Taxpayer was not entitled to disputed input tax deductions relating to goods and services provided to it in connection with client matters where the clients were removed from the Companies Register when the Taxpayer worked on their matters because:
    - The Taxpayer acquired the goods and services outright. It has not shown that it acquired them on behalf of clients, as an agent.
    - However, the Taxpayer has not shown that the goods and services were used for making taxable supplies:
        - Section 20A of the GSTA (Goods and services tax incurred relating to determination of liability to tax) did not apply to deem client-related goods and services to have been used for making taxable supplies. To the extent that the goods and services related to the Taxpayer's client tax matters, the Taxpayer has not shown that it had challenged or appealed against an assessment or determination made in relation to the same matters. Nor has it shown its clients had incurred expenditure on such matters.
        - The goods and services were insufficiently connected to the making of taxable supplies. The Taxpayer cannot have been making supplies to clients that were removed from the Companies Register when it worked on their matters because the companies did not exist, and the likelihood of the removed companies being restored to the register was remote.
18. The Taxpayer was entitled to disputed input tax deductions to the extent they related to goods and services provided to it in connection with client matters, where the clients were on the Companies Register when the Taxpayer worked on their matters, and where it held the required tax invoices or tax invoices were not required, because:
    - The Taxpayer acquired the goods and services outright. It has not shown that it acquired them on behalf of clients as an agent.
    - The goods and services were used for making taxable supplies.
        - For the same reasons outlined above, s 20A of the GSTA did not apply to deem the goods and services to have been used for making taxable supplies.
        - However, the Taxpayer was making taxable supplies and the goods and services it acquired were sufficiently connected with the making of those supplies. Where the Taxpayer had issued invoices for its services, the general time of supply rule applied to deem the supplies to have been made when the invoices were issued. Where the Taxpayer had not issued invoices, the Taxpayer's supplies were associated supplies deemed to have been made when the services were performed. This is based on evidence the Taxpayer was associated with its clients which the Taxpayer has not disproved.
19. The Taxpayer was not entitled to disputed input tax deductions relating to goods and services provided to it in connection with a property it leased because:
        - The Taxpayer acquired the goods and services. The Taxpayer had shown that it leased the property and was required to acquire goods and services to meet its obligations under the lease.
        - However, the Taxpayer had not shown the goods and services were used for making taxable supplies. The Taxpayer used the house and out-buildings on the property for making both taxable and exempt supplies. However, it claimed a deduction for the total input tax charged on the goods and services without excluding any amount for the exempt use. Nor had it sufficiently shown the area of the house and out-buildings that were used for making taxable supplies or the actual time it used the areas for making taxable supplies. Without this information it was not possible to estimate the extent to which the goods and services were used for making taxable supplies.

Issue 2 | Take tuarua: Output tax

20. This issue concerns whether the Taxpayer was liable for output tax on an amount it received.

21. Section 20 deals with a registered person's obligation to calculate tax payable for each taxable period. A registered person must calculate the tax that is payable for each taxable period that applies to the person. For this purpose, output tax must be attributed to a taxable period. Output tax is tax charged on supplies made by the person in the course of their taxable activity. Subject to some exceptions which are not relevant for this issue, a person who is registered on the payments basis must attribute output tax to a taxable period to the extent that payment for the supply the output tax relates to is received in the period.

22. The Taxpayer was registered on the payments basis. Consequently, the Taxpayer was required to attribute output tax charged on services supplied in the course of the Taxpayer's taxable activity to the taxable period in which payment for the services was received.

23. CCS argued that the payment was a payment for services, whereas the Taxpayer argued that it was a loan repayment and as loan repayments are exempt from GST the Taxpayer was not required to include the payment in its return.

24. TCO decided that the Taxpayer had not met the onus of proving that CCS's proposed adjustment including output tax on the amount it received was wrong. The Taxpayer had endeavoured to do this by showing that the payment was a loan repayment. However, the Taxpayer had not provided any documentary evidence of a loan having been made. Also, the debtors' schedule that the Taxpayer provided was inconsistent with the payment having been a loan repayment, as was the Taxpayer's return for the 31 March 2019 taxable period. Those items supported a conclusion that the payment was a payment of fees.

Issue 3 | Take tuatoru: Shortfall penalties

25. This issue concerns with whether the Taxpayer was liable for shortfall penalties for gross carelessness or, in the alternative, shortfall penalties for not taking reasonable care. In either case, CCS accepted the penalties would be reduced by 50% for previous behaviour. For this issue all legislative references are to the Tax Administration Act 1994 (TAA) unless stated otherwise.

26. CCS argued that the Taxpayer was liable for shortfall penalties for gross carelessness or, in the alternative, shortfall penalties for not taking reasonable care (in either case, reduced by 50% for previous behaviour). The Taxpayer argued that it was not liable for shortfall penalties for gross carelessness or shortfall penalties for not taking reasonable care.

Gross carelessness

27. Section 141C of the TAA imposes a shortfall penalty for gross carelessness on a taxpayer if the following requirements are satisfied:[6]

- The taxpayer has taken a tax position.
- Taking the tax position has resulted in a tax shortfall.
- The taxpayer has been grossly careless in taking the taxpayer's tax position. Gross carelessness means doing or not doing something in a way that, in all of the circumstances, suggests or implies a complete or high level of disregard for the consequences (s 141C(3)):
  - Gross carelessness is characterised by conduct which creates a high risk of a tax shortfall occurring where that risk and its consequences would have been foreseen by a reasonable person in the circumstances.[7]
  - The test for gross carelessness is not whether the taxpayer actually foresaw the probability that their act or omission would cause a tax shortfall but whether a reasonable person would have foreseen that probability. Whether the taxpayer has acted intentionally is not a consideration.[8]
  - A person who takes reasonable care is not grossly careless.[9]

28. The penalty payable for gross carelessness is 40% of the resulting tax shortfall.

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

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

8 *Case W4* at [60]; *Case 9/2014* (2014) 26 NZTC 2-019 at [88].

9 *Case W4*; *Re Carlaw and FCT* 95 ATC 2166 (AAT); *Re Sparks and FCT* [2000] AATA 28 and see also *Pech v Tilgals* [1994] ATC 4206.

Not taking reasonable care

29. Section 141A imposes a shortfall penalty for not taking reasonable care on a taxpayer if the following requirements are satisfied:[10]
    - The taxpayer has taken a tax position.
    - Taking the tax position has resulted in a tax shortfall.
    - The taxpayer has not taken reasonable care in taking the taxpayer's tax position:[11]
        - The test of "reasonable care" is whether a reasonable person in the taxpayer's circumstances would have foreseen a tax shortfall as a reasonable probability. It is not a question of whether the taxpayer actually foresaw the probability.
        - Taking reasonable care includes exercising reasonable diligence to determine the correctness of a return. It also includes keeping adequate books and records to properly substantiate a return and generally making a reasonable attempt to comply with the tax law.
        - The "reasonable care" test does not require the commitment of unlimited time and money or other resources. The effort required of the taxpayer is commensurate with the reasonable person in the taxpayer's circumstances.[12]
30. The penalty payable for not taking reasonable care is 20% of the resulting tax shortfall.

Application

31. TCO concluded that the Taxpayer was liable for shortfall penalties for gross carelessness because:
    - The Taxpayer took tax positions that were not correct.
    - It was likely that there was resulting tax shortfalls in all the taxable periods in dispute.
    - The Taxpayer was grossly careless when it took its tax positions. A reasonable person in the Taxpayer's position would have:
        - Known tax invoices were required and foreseen the risk of tax shortfalls if input tax deductions were claimed without them. By claiming input tax deductions without the required tax invoices, the Taxpayer showed a high level of disregard for the consequences.
        - Appreciated there was an insufficient nexus between goods and services acquired in connection with clients removed from the Companies Register when it worked on their matters and the making of any taxable supplies (given the companies did not exist and the likelihood of the removed companies being restored to the register was remote) and foreseen the risk of tax shortfalls if input tax deductions were claimed.
        - Known that the supply of accommodation in any dwelling is an exempt supply and foreseen the risk of tax shortfalls if all the input tax charged on the goods and services provided to it in connection with the leased property was deducted without excluding any amount for the residential use.
        - Foreseen the risk of a tax shortfall where the available documentary evidence recorded the amount it received as consideration for a taxable supply and not a loan repayment.
32. The requirements for shortfall penalties for not taking reasonable care were also met. However, shortfall penalties for gross carelessness should be imposed because they are the higher penalty.

Issue 4 | Take tuawhā: Time bar

33. All statutory references for this issue to the TAA unless otherwise stated.
34. The issue concerns whether s 108A prohibited the Commissioner from increasing the assessment for the Taxpayer's September 2018 GST period (September Period).
35. The Taxpayer argued that the September Period became time barred on 31 October 2022 because the due date for payment of tax owing for the period occurred on 28 October 2018.

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

11 *Case W4* (2003) 21 NZTC 11,034.

12 See also *Case W3* (2003) 21 NZTC 11,014 and *TRA 007/12* [2014] NZTRA 08, (2014) 26 NZTC 2018.

36. CCS argued that the time bar applied from 31 March 2023 because that was the day that was four years from the end of the GST return period in which the Taxpayer provided its return for the September Period.
37. TCO analysed the law as laid out by s 108A and concluded:
    - A GST assessment becomes time barred when four years have passed from the end of the GST return period in which a return for the assessed period was provided.
    - The GST return period will be the "taxable period" the day the return was provided falls into.
    - A registered person's taxable period is determined by reference to the frequency with which the person files returns under s 15(1) (either monthly, bi-monthly or 6-monthly) and each such period will end on the last day of a month.
    - Tax payable for a taxable period must be paid on the 28th day of the month following the end of the taxable period, provided the following month is not December or January. If the following month is December, tax must be paid no later than 15 January and if the month following is April, tax must be paid no later than 7 May.
38. Based on this, TCO concluded that the Commissioner was not time barred from amending the Taxpayer's GST assessment for the taxable period ended 30 September 2018 because:
    - Under s 108A(1) of the TAA the Commissioner is prohibited from increasing an assessment if four years have passed from the end of "the GST return period" in which a return for the assessed period is provided.
    - The Taxpayer filed a return for the taxable period ended 30 September 2018 on 18 October 2018, in the GST return period ended 31 March 2019.
    - The taxable period ended 30 September 2018 becomes time-barred when 4 years have passed from 31 March 2019 (the end of the GST return period); that is, from 1 April 2023.