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TAX INFORMATION Bulletin

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YOUR OPPORTUNITY TO COMMENT

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

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

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Tax Counsel Office
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Ref	Draft type	Title	Comment deadline
PUB00400	Question we've been asked	Income tax – How do the income tax rules apply when a close company provides short-stay accommodation?	2 May 2025
PUB00484	Interpretation statement	Care and Management	26 May 2025
PUB00469	Interpretation statement	Income tax – Whether an off-market share cancellation is made in lieu of the payment of a dividend	3 June 2025

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NEW LEGISLATION

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

GST on accommodation and transportation services supplied through online marketplaces

Originally issued: 19 June 2023

Last updated: 1 April 2025

This special report provides information that explains the GST rules for marketplace operators involved in the supply of ride-sharing/ride-hailing and delivery services for food and beverages, as well as for marketplace operators and listing intermediaries involved in the supply of accommodation services.

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Introduction

This special report provides information on changes to apply goods and services tax (GST) to "listed services" supplied through electronic marketplaces. The Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 was enacted on 31 March 2023. The amendments give effect to changes that require operators of electronic marketplaces to collect GST on supplies of "listed services" that include:

- ride-sharing and ride-hailing
- delivery services for beverages, food, or both, and
- taxable accommodation,

that are performed, provided or received in New Zealand.

The changes took effect on 1 April 2024 unless otherwise stated.

Following enactment of the GST rules for listed services in March 2023, additional changes have been made to ensure the rules are workable and consistent with the policy intent. These changes were included in the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act 2024, which was enacted on 29 March 2024, and include:

- rules to address circumstances where a person, referred to as a "listing intermediary", is interposed between an underlying supplier of taxable accommodation and the operator of an electronic marketplace
- adjustment rules for the flat-rate credit that will enable marketplace operators and listing intermediaries to self-correct errors related to the calculation of the flat-rate credit
- ensuring the value of the flat-rate credit is not reduced when marketplace operators provide a discount for listed services
- only allowing non-individual persons with sales greater than $500,000 in a 12-month period to choose to remain responsible for their own GST obligations
- a clarification to ensure that marketplace operators and listing intermediaries are able to recover their output tax liabilities on supplies they are treated as making from underlying suppliers without this giving rise to additional GST liabilities
- a transitional rule to ensure that marketplace operators and listing intermediaries do not have to account for GST on contracts for taxable accommodation entered into before 1 April 2024, and
- other minor and technical amendments to ensure the legislation reflects the policy intent.

Further changes were made following the enactment of the Taxation (Annual Rates for 2024–25, Emergency Response, and Remedial Measures) Act 2025, which received the Royal assent on 29 March 2025. These changes include:

- rules allowing more flexibility for marketplace operators and listing intermediaries who are required to account for GST on a supply of taxable accommodation
- the option for underlying suppliers to treat the flat-rate credit as assessable income for income tax purposes, enabling GST-inclusive income tax deductions for income tax purposes, and
- other minor and technical amendments to ensure the legislation reflects the policy intent.

These changes are explained in this report.

For general enquiries not covered by the guidance included in this special report, email: platformeconomy@ird.govt.nz.

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

Key features

Scope of GST rules for listed services

Since 1 April 2024, the supply of "listed services" made through an electronic marketplace will be subject to GST whether the person providing the services through the electronic marketplace is registered for GST or not. The new rules will require operators of electronic marketplaces to collect and return GST on supplies of listed services they are treated as making. Marketplace operators will only be required to collect and return GST on supplies of listed services if their total supplies in New Zealand including the listed services exceed, or are expected to exceed, the GST registration threshold of NZ$60,000 in a 12-month period.

The following services, which are further explained later in this report, are included within the scope of "listed services":

- accommodation other than accommodation that would be exempt under the GST Act
- ride-sharing and ride-hailing services
- delivery services for food, beverages, or both,

provided that these services are performed, provided or received in New Zealand.

The new rules apply to marketplace operators regardless of their residence for GST purposes. This means that resident and non-resident marketplace operators need to consider GST registration if they enable the supply of listed services.

Flat-rate credit scheme

A flat-rate credit scheme that requires marketplace operators to pass on a proportion of the GST collected on supplies of listed services to underlying suppliers that are not registered for GST, has been introduced. The flat-rate credit scheme provides a "credit" to underlying suppliers who are not required to be registered for GST because their total supplies are below the GST registration threshold. This is intended to recognise the GST incurred by unregistered underlying suppliers on goods and services used to make supplies of listed services.

Standard GST registration is available for underlying suppliers that do not have to be registered for GST and do not want to apply the flat-rate credit scheme. The flat-rate credit was determined with reference to the average amount of input tax that GST-registered suppliers of listed services recovered. It is not intended to recognise GST on capital assets such as land or vehicles used to make supplies of listed services. This is because a person that supplies listed services, and who is not registered for GST, would not account for output tax on the disposal of such assets.

For underlying suppliers that are registered for GST, they will continue accounting for input tax on their expenses in their own GST returns. They will no longer be responsible for accounting for GST output tax on supplies of listed services as this will be done by marketplace operators unless the underlying supplier has opted out of the marketplace rules.

Opting out of marketplace rules

New provisions enable certain underlying suppliers to opt out of the marketplace rules. The effect of opting out of the marketplace rules means that underlying suppliers, instead of marketplace operators, would continue to be responsible for accounting for GST on supplies of listed services.

Some GST-registered underlying suppliers with larger-scale operations can opt out of marketplace rules provided they meet certain criteria. Agreement will be required between marketplace operators and underlying suppliers who choose to opt out of the rules in some circumstances. In other circumstances, underlying suppliers with more significant operations will be able to unilaterally opt out of the marketplace rules by notifying the marketplace operator. If an underlying supplier opts out of the marketplace rules, they choose to remain responsible for their own GST obligations in respect of supplies they make through electronic marketplaces.

The provisions enabling underlying suppliers to opt out of the rules came into force on 1 April 2023 to enable these rules to be used ahead of the other rules applying from 1 April 2024.

Listing intermediaries

Legislative changes made in March 2024 introduce new rules for "listing intermediaries" to supplement the electronic marketplace rules to ensure that the rules for listed services (particularly the flat-rate credit scheme for unregistered underlying suppliers) work effectively.

When a property manager or agent for an underlying supplier of taxable accommodation enters into an agreement with an operator of an electronic marketplace to list accommodation on behalf of underlying suppliers, the electronic marketplace rules may not work appropriately on their own because the marketplace operator might not have any information about the underlying supplier that is necessary for administering the flat-rate credit scheme. In this situation, the property manager or agent (referred to as a "listing intermediary") will be responsible for all requirements related to the flat-rate credit (instead of those obligations being on the marketplace operator).

The listing intermediary will also be treated as making a zero-rated supply of the accommodation provided by the underlying supplier to the marketplace operator, unless they are able to agree with the marketplace operator that they are liable for GST at the 15% rate on supplies of taxable accommodation. Certain conditions apply to determine whether the listing intermediary is eligible to enter into such an agreement.

Consequential amendments

The marketplace rules for listed services are based on existing rules in the GST Act that apply to marketplace operators. These rules have been present in the GST Act since 1 October 2016 when the rules for GST on remote services were introduced. They were expanded on 1 December 2019 with the introduction of GST on distantly taxable goods.

Amendments have been made to the rules for electronic marketplaces, where appropriate, to ensure that those same rules continue to apply to marketplace operators that are treated as suppliers of listed services.

Background

GST is a broad-based consumption tax that applies to the supply of most goods and services made in New Zealand. To ensure GST remains simple, fair, and efficient, a fundamental principle of New Zealand's GST system is that GST should apply to all consumption that occurs in New Zealand.

GST came into force in New Zealand in October 1986 before the introduction of e-commerce and the growth and popularity of the internet. Since then, the scope of GST has been expanded to apply in circumstances not originally envisaged when GST was introduced.

Changes were made in 2016 to ensure that GST applied to cross-border supplies of "remote services". This included remote services that are supplied through electronic marketplaces such as app sales through app stores.

Changes were also made in 2019 to ensure that GST applied to supplies of certain imported goods. These changes included requirements that operators of electronic marketplaces –instead of the seller on the marketplace – would become liable for collecting and returning GST on goods supplied through the marketplace to a consumer providing a delivery address in New Zealand.

These changes were both premised on the principles of maintaining a broad-based GST system, under which GST applied to the broadest possible range of goods and services in New Zealand, and of promoting and protecting the sustainability of the GST base. The application of GST to these cross-border supplies of goods and services also removed distortions that arose when GST was typically being collected by those that provided the same goods and services within New Zealand.

These prior reforms followed consideration and consultation by the Organisation for Economic Co-operation and Development (OECD). In April 2021, the OECD published its report *The Impact of the Growth of the Sharing and Gig Economy on VAT/GST Policy and Administration.* This report outlined a range of options that jurisdictions could implement depending on their overarching policy objectives with its VAT/GST system. One option considered in this report is introducing rules requiring platform operators to collect and return GST on supplies of goods and services they enable sellers to make under a "deemed supplier" or "full liability regime" model. The Government enacted rules broadly aligned with this option as part of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 and following the Government discussion document ***The role of digital platforms in the taxation of the gig and sharing economy***, which was published in March 2022.

Effective date

The amendments incorporating "listed services" into the GST Act generally take effect on 1 April 2024.

The amendments enabling underlying suppliers to opt out of the marketplace rules, provided criteria are met, have effect from 1 April 2023, being the day after the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023 received the Royal assent (31 March 2023). This includes the amendments enabling the Commissioner of Inland Revenue (the Commissioner) to issue determinations that set out the criteria a person must meet before they can enter an opt-out agreement with a marketplace operator.

Transitional rule for taxable accommodation

In March 2024, the Government introduced a transitional rule that ensures listing intermediaries and operators of electronic marketplaces do not have to account for GST on contracts for taxable accommodation entered into before 1 April 2024, provided certain conditions are met. The transitional rule will apply when the relevant supplies under those contracts are made on or after 1 April 2024. For more information see "**Transitional rule for taxable accommodation**".

Key terms

There are several terms that have a specific meaning under these new rules.

Listed services – The services listed in section 8C(2). The following services are included within the scope of "listed services":

- accommodation other than accommodation that would be GST-exempt
- ride-sharing/ride-hailing services
- delivery services for food, beverages, or both,

when these services are performed, provided or received in New Zealand.

Further information about the scope of "listed services" is included in the detailed analysis that follows.

Underlying supplier – The person who would be the supplier of taxable accommodation, ride-sharing/ride-hailing, or food or beverage delivery services for GST purposes (and would therefore be responsible for returning GST on the services to Inland Revenue) in the absence of a specific provision of the GST Act deeming another person (such as the operator of an electronic marketplace) to be the supplier of those services. Generally, this refers to an accommodation host, driver, or deliverer who makes the supply of services to the consumer, using an electronic marketplace to find buyers for their services.

Accommodation host or **host** – The person who would be the supplier of accommodation services, ignoring the effect of the marketplace rules that treat the operator of the marketplace as the supplier. This will generally be the owner of the land or property that is used to provide accommodation but could also include the person responsible for the operation of a hotel or motel, for example.

Electronic marketplace – Defined in section 2(1) as a marketplace that is operated by electronic means through which a person (the underlying supplier) makes a supply of goods, or of remote services by electronic means, or of listed services, through another person (the operator of the marketplace) to a third person (the recipient). It includes a website, internet portal, gateway, store, distribution platform, or other similar marketplace but it does not include a marketplace that solely processes payments.

Marketplace rules – Rules that require operators of electronic marketplaces to account for GST on supplies they are treated as making. These rules apply when an underlying supplier provides listed services through an electronic marketplace to another person (the recipient). Instead of the underlying supplier accounting for GST on the supply of listed services, it is the marketplace operator that accounts for GST on the supply. The supplier, if registered for GST, will be treated as making a zero-rated supply to the marketplace operator and would therefore account for GST on the supply at the rate of 0% (or, in other words, the underlying supplier should include the value of the supply in the "Zero-rated supplies" box in its GST return).

Listing intermediary – Defined in section 60CB(8) as a person who lists taxable accommodation services on an electronic marketplace on behalf of an underlying supplier who makes those supplies through the electronic marketplace. The definition also requires that the person enters into an agreement with the marketplace operator to list or advertise the services provided by the underlying supplier.

Flat-rate credit – Input tax that must be deducted by the operator of an electronic marketplace that is treated as the supplier of listed services when the underlying supplier has notified the marketplace operator that they are not registered for GST. Section 20(3N) sets out the prescribed rate of the flat-rate credit. For a supply of taxable accommodation, ride-sharing/ride-hailing, or delivery services for food and beverages, as at the date of publication of this special report, the prescribed rate is 8.5% of the value of the supply. The marketplace operator must pass this on to the underlying supplier.

When a listing intermediary is interposed between the underlying supplier of the listed services and the operator of the electronic marketplace, the listing intermediary will be treated as though they are the operator of the electronic marketplace for the flat-rate credit. This means that if the underlying supplier has notified the listing intermediary that they are not registered for GST, the listing intermediary (instead of the marketplace operator) must deduct input tax for the flat-rate credit and pass this on to the underlying supplier. The listing intermediary will also be required to provide the monthly statement to the underlying supplier.

Detailed analysis

Scope of GST rules for listed services

Sections 2(1) definitions of "electronic marketplace", "flat-rate credit", "listed services", 8(3), 8C, 10(6B), 60C and 60CB(8) of the GST Act

The definition of "electronic marketplace" in section 2(1) is amended to reflect the different types of goods and services that can be provided through an electronic marketplace by an underlying supplier.

The definition now sets out that an electronic marketplace is a marketplace operated by electronic means through which another person (an "underlying supplier") may make a supply of certain goods or services through the operator of the marketplace to a recipient of those goods and services. Those goods and services include a supply of remote services, distantly taxable goods, and listed services. The concept of an electronic marketplace remains unchanged, which is essentially an electronic medium that matches buyers and sellers, or allows them to interact, to facilitate the sale and purchase of goods and services. It includes a website, internet portal, gateway, store, distribution platform, or other similar marketplace and excludes a marketplace that solely processes payments.

For these rules to apply, there must be an arrangement that involves an underlying supplier providing services through an electronic marketplace to a recipient. When the recipient of the services contracts directly with a person and there is no third-party operator of an electronic marketplace involved, the marketplace rules for listed services will not apply. The GST treatment of the supply of these services will depend on whether the supplier of the services is registered for GST.

New defined terms have been inserted for "flat-rate credit" and "listed services". The flat-rate credit refers to the deduction a marketplace operator or listing intermediary is required to take as input tax, and that must be passed on to underlying suppliers that are not registered for GST in recognition of the GST on goods and services they use to make supplies of listed services.

The definition of "listed services" refers to those services set out in section 8C(2). Listed services are not set out in the Interpretation provision of the GST Act and are instead set out in section 8C.

Section 60CB(8) defines the term "listing intermediary" as a person who lists services described in section 8C(2)(a) on an electronic marketplace on behalf of an underlying supplier who makes those supplies through the electronic marketplace. The definition also requires that the person enters into an agreement with the marketplace operator to list or advertise the services provided by the underlying supplier.

Section 8C sets out the substantive rules for listed services and signposts to other provisions in the GST Act that are relevant.

The "listed services" are:

- accommodation other than accommodation that would be GST-exempt (section 8C(2)(a))
- ride-sharing and ride-hailing services (section 8C(2)(b)(i)), and
- delivery services for food, beverages, or both (section 8C(2)(b)(ii)).

Section 8C(7) expands the scope of listed services to include services that are closely connected with these services that are advertised, listed, or otherwise made available through an electronic marketplace.

Accommodation other than accommodation that would be GST-exempt

Included in the definition of "listed services" is accommodation other than accommodation that is exempt from GST under section 14(1)(c). Accommodation is exempt under section 14(1)(c) if it is accommodation provided in a dwelling that is used by the person as their principal place of residence and for which they have rights of quiet enjoyment.

All other forms of accommodation provided in New Zealand are taxable, usually at 15%. This includes short-term rental and visitor accommodation. However, the GST Act includes special rules for supplies of certain domestic goods and services provided during a stay of more than four weeks in a "commercial dwelling". These rules provide for a special tax rate of 9% on these supplies. Section 10(6B) overrides these special rules when accommodation is supplied through an electronic marketplace. This is because it would be impractical for marketplace operators to identify whether the listed services would qualify as domestic goods or services supplied during a stay in a commercial dwelling or another type of taxable accommodation. Therefore, all accommodation services provided through an electronic marketplace (other than exempt accommodation) will be subject to GST at the standard rate of 15% when it is provided or received in New Zealand.

For the avoidance of doubt, this also includes accommodation in a room provided to a guest in a host's principal place of residence (that is, their own home). In these circumstances, the room being provided to the guest is not the guest's principal place of residence, nor would the guest have rights of quiet enjoyment.

It will generally be straightforward to determine whether accommodation has been provided or received in New Zealand. This is because underlying suppliers of accommodation in New Zealand will provide the marketplace operator through which accommodation is provided with the address of the property where the accommodation is provided.

A person that owns a property in which taxable accommodation is provided through an electronic marketplace may engage the services of a property manager to manage the property, for example holiday house rentals or apartments with management rights arrangements. In such circumstances, it will generally be the case that the person that is supplying the accommodation through the electronic marketplace will be the owner of the property and not the property manager. This means that the owner of the property is the underlying supplier.

In some circumstances, the rules for listing intermediaries may apply. This is likely to be the case when the property manager enters into a contractual arrangement in their own name with the marketplace operator to list accommodation on an electronic marketplace on behalf of the property owner. These rules are discussed further at "**Listing intermediaries**".

In some situations, such as motels, a person (the lessee) may purchase a business lease from the freehold property owner (the lessor) and will run the accommodation business. In this situation, the lessee is supplying the accommodation through an electronic marketplace. It is therefore the lessee who is the underlying supplier, not the lessor.

The disposal of property used to provide accommodation through an electronic marketplace is not a listed service.

Ride-sharing and ride-hailing

The definition of ride-sharing and ride-hailing services is set out in section 8C(8). It sets out that these services are provided through an electronic marketplace that involves the engagement of a personal driver to transport a person to their chosen destination.

Ride-sharing and ride-hailing services therefore would not include services where the travel route is pre-determined by the supplier such as a bus route, a ferry service, cruise, or flight between certain destinations. In these cases, the passenger is not usually able to direct the driver towards a particular place, destination, or route. The passenger will also not usually have control over both the time and the destination.

Many types of transportation services involve the customer purchasing a service directly from a GST-registered supplier of transportation services, such as a bus company or boat charter. In these cases, the services are not provided through an electronic marketplace so the rules for marketplace operators do not apply. This is because the rules for marketplace operators apply only when there is an underlying supplier (of, for example, a listed service), a marketplace operator, and a recipient of the services. In situations when a person contracts directly with the supplier of the services, there is no marketplace operator involved.

Delivery services for food and/or beverages

The transportation of beverages, food, or both these goods is included as a listed service. This does not include the supply of beverages or food itself. It is only the delivery services that are included in the definition.

The marketplace rules for listed services do not apply when a business enters a contract with a person for the delivery of food and/or beverages, and that business engages the services of an independent contractor or an employee to carry out the delivery services. This is because in such circumstances the business is the supplier of the services (and not the independent contractor or the employee). GST will usually already apply to these services because the person providing them will generally be registered for GST.

In contrast, when a person uses an electronic marketplace operated by a third party to enter a contractual relationship with other persons for food and/or beverage delivery services, the marketplace rules for listed services will usually treat the marketplace operator as the supplier of these services for GST purposes. It will therefore be the marketplace operator with the obligation to return GST on the services to Inland Revenue and not the deliverer.

Example 1: Delivery services for food provided but not through an electronic marketplace

Andraya's Eats Ltd carries on a business of delivering restaurant meals to customers via its app. Andraya's Eats Ltd is registered for GST and GST applies to its services.

Andraya's Eats Ltd's business model involves arranging for independent contractors to undertake the delivery of restaurant meals to Andraya's Eats Ltd's customers. There is no contractual relationship between the independent contractors and Andraya's Eats Ltd's customers.

The rules for marketplace operators do not apply because Andraya's Eats Ltd is not an electronic marketplace. This is because the independent contractors that provide delivery services are not providing delivery services under any direct contractual agreement with Andraya's Eats Ltd's customers. The independent contractors are instead providing services to Andraya's Eats Ltd.

Andraya's Eats Ltd should continue to return GST under the standard GST rules.

Closely connected services

Section 8C(7) expands the scope of listed services to include services that are closely connected with a "listed service" referred to in section 8C(2). This means that marketplace operators are required to account for GST on these services if these services are advertised, listed, or otherwise made available through the electronic marketplace.

This is intended to include services that are ancillary to the listed service, such as cleaning, where a fee is charged for such services as part of the overall supply of a listed service made through an electronic marketplace.

Example 2: Cleaning services

Jenny seeks accommodation on Waiheke Island for an upcoming holiday. She wants to stay in a holiday home on the beachfront and uses an electronic marketplace that offers accommodation to find a suitable place to stay.

Geoff provides accommodation in his property through the electronic marketplace.

Jenny pays a nightly rate to the electronic marketplace. Jenny is also charged a cleaning fee at the end of her stay. The electronic marketplace collects the cleaning fee as part of the total consideration that it collects from Jenny.

The marketplace operator would be required to account for GST on the cleaning fee as it corresponds to a service that is closely connected with taxable accommodation, which is a listed service.

Although cleaning services are a common example, the phrase "closely connected services" is intended to be broad and capture all services that are closely connected to the listed services and that are advertised, listed or otherwise made available through the electronic marketplace.

An exception to the rule exists for closely connected services that are supplied by a marketplace operator to the recipient of the listed service. This is because the services are separate to the services provided by the underlying supplier. This is intended to exclude services such as a foreign exchange reserve that a marketplace operator may provide its customers.

Example 3: Reserving a foreign exchange rate

David is overseas-based and is looking for accommodation in New Zealand for an upcoming holiday. He uses an electronic marketplace for these purposes.

The marketplace operator offers a service to its customers that enables them to lock in a foreign exchange rate. David is not sure when he will visit New Zealand but wants to reserve the foreign exchange rate that is available to him at the time he is browsing for accommodation.

This service is not closely connected with the supply of a listed service because the service is offered directly by the marketplace operator to David. The marketplace operator would not account for GST on the supply of this service under the rules for listed services. It may need to account for GST on the supply of this service to David under other GST rules.

A service would not be considered closely connected with a listed service if the service did not arise because of the listed service itself. The effect of this is that services which are not ancillary to a listed service, such as rental vehicle hire or a tourist attraction, would not be included within the scope of listed services and the marketplace operator would not account for GST on these supplies under the rules for listed services.

When marketplace operators are treated as suppliers

Amended section 60C provides that the operator of an electronic marketplace is treated as the supplier of listed services if the marketplace operator:

- authorises a charge for the supply of listed services to the recipient
- authorises the delivery of the supply of listed services to the recipient, and/or
- sets a term or condition under which the supply of listed services is made, whether directly or indirectly.

This applies whether the marketplace operator is a resident or non-resident for GST purposes in New Zealand. It also applies whether the underlying supplier of the listed services is a resident or a non-resident for GST purposes in New Zealand.

These are the same tests that apply to determine whether a marketplace operator is treated as the supplier of remote services supplied in New Zealand.

Marketplace operators will not be treated as the supplier of listed services if none of these tests are met. This means that a person that runs a website that contains a messaging board enabling a person to list properties available for rent may not be a marketplace operator.

The following explains in more detail what is meant by "authorise the charge for the supply" and "directly or indirectly set a term or condition under which the supply is made".

Meaning of "authorise the charge for the supply"

The meaning of "authorise the charge for the supply to the recipient" is broad, covering the situation when the marketplace authorises the charge on behalf of the underlying supplier of the services or as a processing agent for the underlying supplier. However, providers that only process payments are excluded from the definition of "electronic marketplace".

An electronic marketplace authorises the charge to the recipient if it communicates the liability to pay to the customer, or otherwise influences whether or when the customer pays for the supply. This may be done by initiating the process through which the recipient is charged and includes when the marketplace connects the recipient to a third-party payment processor who receives the marketplace operator's instruction. To authorise the charge, it is not necessary for the marketplace operator to collect or receive the payment, or be involved in each of the steps in the payment authorisation process.

Meaning of "directly or indirectly set a term or condition under which the supply is made"

The meaning of "directly or indirectly set a term or condition under which the supply is made" is very broad. This concept looks beyond the formal contractual relationship to the influence exercised by the marketplace operator. The marketplace operator does not need to have any direct involvement in determining the contractual arrangements between underlying suppliers and buyers using the marketplace to be responsible for GST on supplies.

A requirement for underlying suppliers to comply with the marketplace's listing policies will in many cases mean that the marketplace does (at least indirectly) set a term or condition under which the supply is made, meaning that the marketplace operator will be responsible for GST on the supply. However, this may not be true in all cases and will depend on what the marketplace's specific listing policies are.

The "directly or indirectly" test is a proxy for the level of control or influence the marketplace operator has over the sale and any post-sales processes, such as customer complaints and refunds. A mere requirement that listings comply with New Zealand's regulatory requirements or, for example, that listings do not contain offensive language is not sufficient to meet this test.

However, there are several marketplace listing policies that will meet this test, including:

- The offer, acceptance, payment, or delivery of the services is to be communicated through the marketplace.
- The underlying supplier must accept one or more specific payment methods.
- The marketplace operator has the right to withhold the recipient's payment from the underlying supplier until the contractual performance of the services is completed.
- Use of the marketplace's grievance or dispute management procedures for underlying suppliers and recipients.
- The marketplace operator has the right to set the price for which listed services are sold.
- Underlying suppliers are required to meet particular performance requirements, such as requiring them to maintain a minimum customer rating to supply listed services on the marketplace.
- Underlying suppliers are required to display a rating based on stipulated behaviours relating to that underlying supplier's conduct.

In practice this means there will be very limited circumstances when an electronic marketplace operator will not be responsible for GST on supplies of listed services though the marketplace.

Example 4: Marketplace operator treated as the supplier of taxable accommodation

Chaz Intermediaries Ltd is a New Zealand tax resident and runs a website that connects accommodation hosts with guests. Hosts create an account on the website where they can upload photographs of their property, list dates that the property is available, and set a nightly rate.

Chaz Intermediaries Ltd offers this service for a fee that it charges hosts. Guests can book properties that are listed by hosts provided the property is available. Chaz Intermediaries Ltd connects the guest to a third-party payment processing portal which processes the payment for the booking.

Because Chaz Intermediaries Ltd authorises the charge for the supply of taxable accommodation, it is treated as the supplier of the accommodation to the guests.

Example 5: Website enables accommodation booking – website operator not a marketplace operator

Kraymond's List Ltd developed a smartphone app that lets users post community notices and classified advertisements for a small upfront listing fee. Several short-term accommodation hosts list properties available for rent on it. Guests can use the app to communicate with the hosts directly, although there are no rules preventing hosts and guests from communicating via other mediums such as email, phone, or other messaging apps, nor from posting links to listings on third-party websites.

Hosts manage property bookings directly, often through the messaging service offered by the app. Guests typically pay the hosts a deposit via internet banking transfer before staying in the property, and at the end of their stay, pay the balance of the booking. However, hosts can set their own policies as to whether they require a deposit to be paid upfront and, if so, how much the deposit is.

Aside from removing listings that are fraudulent or offensive, Kraymond's List Ltd does not moderate listings or intervene in disputes between hosts and guests.

Kraymond's List Ltd does not set any terms or conditions under which the supply of accommodation is made. It also does not authorise the charge for the supply of the accommodation. It is therefore not treated as the supplier of accommodation.

Listed services before 1 April 2024

The marketplace rules for listed services take effect on 1 April 2024. This means if a listed service is supplied through an electronic marketplace before 1 April 2024, the marketplace operator is not treated as the supplier of the services, and it would not account for GST on the sale of the services.

Example 6: Listed services purchased before 1 April 2024

Gerard and Nicole are based overseas. They purchase accommodation in New Zealand through an electronic marketplace in March 2024. The accommodation is booked for June 2024.

The marketplace operator is not treated as the supplier of the accommodation, and it therefore does not account for GST on the sale.

There are no special rules that determine the time of supply for listed services. The time of supply for listed services will therefore generally be the earlier of the time an invoice[1] is issued, or a payment is received, for the supply.

While there are no special rules that determine the time of supply for listed services, an optional accounting rule allows for GST on supplies of taxable accommodation made through electronic marketplaces to be accounted for up to seven days after the performance of the services is completed. This accounting rule is explained under "**Optional accounting rule for taxable accommodation**".

Additionally, a transitional rule exists for contracts for taxable accommodation that were entered into before 1 April 2024. This transitional rule is explained under "**Transitional rule for taxable accommodation**".

When a supply of listed services is made through multiple electronic marketplaces

Section 60C(3) contains an ordering rule to determine which marketplace operator is treated as the supplier when there is more than one marketplace operator involved in a single supply of listed services. Under this rule, it is the first marketplace operator that authorises the charge for the listed service or receives the consideration for the supply of the listed service that is treated as the supplier.

When a marketplace operator is treated as the supplier of listed services, sections 8C(3) and 60(1C) apply. Under these rules:

- The person that provides the services through the electronic marketplace (the underlying supplier) is treated as having supplied those listed services to the operator of the electronic marketplace. These services are zero-rated under section 11A(1)(jc) and the underlying supplier therefore does not collect output tax on this supply.
- The operator of the marketplace receives the services from the underlying supplier and does not claim input tax for the services because the supply is zero-rated. The marketplace operator is also treated as supplying those same services to the recipient of the services. The supply of these services is standard rated when the services are performed, provided or received in New Zealand. This means the marketplace operator is required to account for GST on the supply it is treated as making.

The obligation for the marketplace operator to account for GST on the supply it is treated as making applies in all circumstances provided the relevant tests are met (see "**When marketplace operators are treated as suppliers**").

Whether a person is considered an operator of an electronic marketplace through which an underlying supplier makes a supply of listed services will depend on the specific facts. For instance, automated inventory tracking systems such as those used in the accommodation industry[2] or payment processing systems, would not be considered electronic marketplaces in and of themselves.

1 This is a document notifying an obligation to make payment.

2 For example, a Central Reservation System or Computerised Reservation System (CRS), or a Global Distribution System (GDS).

How marketplace operators account for GST on supplies of listed services they are treated as making

Section 8C(3) provides that section 60(1C) applies when a supply of listed services is made through an electronic marketplace. The effect of this is that, for a supply of listed services:

- The underlying supplier is treated as making a supply to the operator of the electronic marketplace and this supply is zero-rated (under section 11A(1)(jc)) if the underlying supplier is GST-registered, or if the underlying supplier is not GST-registered the supply is not subject to GST.
- The marketplace operator is treated as making this same supply, with the addition of GST at the standard rate of 15%, to the recipient of the listed services.

When a marketplace operator has an agreement that entitles the underlying supplier to the consideration paid by the recipient of the listed services, it will need to consider whether its contracts need to be altered to allow it to retain, and own, enough of the funds paid by the customer so it can fund its GST liability in respect of the listed services.

For GST purposes, this would mean that the consideration paid for the supply that is treated as being made by the marketplace operator to the recipient of the listed services is more than the consideration paid by the marketplace operator for the deemed supply of listed services made by the underlying supplier to the marketplace operator under section 60C(1)(a). In such a situation, paying GST to Inland Revenue does not give rise to additional consideration for facilitation services the underlying supplier receives from the marketplace operator.

Example 7: GST on a supply of listed services when marketplace operator is treated as supplier

A supply of listed services with a value of $115 including GST is made through an electronic marketplace.

For GST purposes, the marketplace operator is treated as the supplier under section 60C.

The parties have agreed the marketplace operator is entitled to retain enough of the funds from the recipient of the listed services to fund its GST liability (in this situation, $15). Therefore, the value of the supply from the perspective of the underlying supplier is $100. This applies whether the underlying supplier is GST-registered or not. If the underlying supplier is GST-registered, they would account for output tax on the supply at the rate of 0%. GST does not apply if the underlying supplier is not registered for GST.

The marketplace operator can use $15 of the $115 paid by the recipient of the listed services to satisfy its GST liability. The remaining $100, the GST-exclusive value of the listed services, is payable to the underlying supplier for its deemed supply to the marketplace operator.[3]

For GST purposes, when a marketplace operator or listing intermediary recovers or deducts an amount from a payment due to the underlying supplier and uses this amount to satisfy its output tax liability for the supply it is treated as making, this does not give rise to any GST implications. This is because section 60C(3B) and (3C) provides that no consideration arises for the collected amount in this situation under the GST Act.

When services are performed, provided or received in New Zealand

The GST Act has rules that determine where the place of supply for goods or services is. The general rules stipulate that goods or services are deemed to be supplied in New Zealand if the supplier is a resident in New Zealand, and goods and services are deemed to be supplied outside New Zealand if the supplier is a non-resident. These rules are contained in section 8.

Amendments to section 8 override the general rules. The amendments (to section 8(3)(c) and new section 8(3)(d)) ensure that a supply of listed services that is performed, provided or received in New Zealand is treated as a supply made in New Zealand and will therefore be subject to GST. This applies even if the underlying supplier of a listed service is a non-resident (such could be the case for accommodation provided in New Zealand, as the underlying landowner could be a non-resident) or the marketplace operator is a non-resident.

Unlike the rules for remote services and distantly taxable goods, there are no special rules that enable a different GST treatment for listed services. This means that they will always be subject to GST at the standard rate when they are performed, provided or received in New Zealand. It also does not matter if the recipient of the services is a non-resident. For example, a non-resident tourist staying in accommodation in New Zealand would be required to pay GST on their accommodation.

3 For simplicity, this example ignores the fees charged by marketplace operators for providing facilitation services to underlying suppliers.

There are also no special rules that apply to determine whether listed services are "performed, provided, or received" in New Zealand. The ordinary meaning of these terms will apply to determine whether the services are listed services that would be subject to GST when provided through an electronic marketplace.

GST treatment of facilitation services and commissions related to listed services

Marketplace operators typically charge underlying suppliers a fee for facilitation services related to the supply of listed services, often in the form of a commission on the sale. "Facilitation services" involve connecting underlying suppliers with buyers.

The GST treatment of facilitation services will be subject to the ordinary GST rules if the supplier of the services (being the marketplace operator) is a tax resident in New Zealand. In this situation, the facilitation services will be subject to GST at the standard rate, regardless of whether the recipient (the underlying supplier of listed services) is registered for GST.

The GST rules for remote services apply to determine the GST treatment of facilitation services supplied by a person who is a non-resident for GST purposes. In this case, a supply of facilitation services is subject to GST at the standard rate if the supply is to a New Zealand-resident person who is not registered for GST. Under these rules, GST does not normally apply if the recipient of the services is a GST-registered person, although the marketplace operator can choose in this situation to treat the supply as zero-rated.

The following example sets out how GST applies in a situation when a marketplace operator is:

- treated as the supplier of listed services to a recipient (when GST applies at the standard rate of 15% if the services are performed, provided or received in New Zealand), and
- supplying separate facilitation services to the underlying supplier of the listed services.

Example 8: Marketplace operator supplying facilitation services to a GST-registered underlying supplier and treated as supplying listed services to another person

2K's Ride Services (2KRS) is an electronic marketplace through which underlying suppliers make supplies of listed services. It is not resident in New Zealand for GST purposes.

Wiremu provides ride-sharing services through 2KRS. He is registered for GST and has notified 2KRS of his GST registration.

Richeile also provides ride-sharing services through 2KRS and has notified the marketplace operator she is not registered for GST.

2KRS has an agreement with drivers that use 2KRS's app that entitles it to retain 20% of the total GST-exclusive fare for ride-sharing services that drivers supply to passengers using 2KRS's app. This 20% fee is the amount 2KRS charges for its facilitation services.

Two passengers purchase rides from Wiremu and Richeile through 2KRS for $57.50 including GST (a GST-exclusive value of $50).

Facilitation services

Because Wiremu is GST-registered, 2KRS can choose whether the facilitation services ($10) it provides to Wiremu are treated as supplied outside New Zealand, in which case, there are no associated GST obligations with the supply. Alternatively, it can choose to treat the supply of facilitation services as zero-rated, in which case it would include this in its GST return (in the "Zero-rated supplies" box).

Because Richeile has notified 2KRS she is not registered for GST, 2KRS is required to account for GST on the supply of its facilitation services to Richeile. It must include the facilitation services supplied to Richeile in the "Total sales and income" box of its GST return.

Listed services

2KRS is required to account for GST on the supply of listed services it is treated as making (that is, the rides provided by Wiremu and Richeile to their passengers).

The value of the listed service ($50) is not reduced by the value of the facilitation services ($10) supplied by 2KRS to Wiremu or Richeile.

Adjustments for supplies of listed services

The amendments treat the marketplace operator, instead of the underlying supplier, as the supplier of listed services. It follows that when adjustments for inaccuracies need to be made, marketplace operators will need to apply the rules as if they were the supplier of services, even though another person (an underlying supplier) is the contractual supplier of the services. This means that, in these circumstances, it is the marketplace operators (instead of the underlying suppliers) that must provide the supply correction information to the recipient and make the adjustments.

Section 25 applies when a GST-registered supplier returns too much or too little GST because of either a mistake, subsequent alteration to, or cancellation of a supply. This includes instances when, for example, the previously agreed consideration has been reduced through the offer of a discount or refund (whether partial or in full). When a marketplace operator has returned too much or too little GST to Inland Revenue as the result of an inaccuracy referred to in section 25(1) (such as an incorrect amount of consideration), section 25(2) provides that it should make an adjustment in its GST return when it is apparent that too much or too little GST has been returned.

When there is an alteration to or cancellation of a supply of listed services, section 19NB also requires the marketplace operator to provide supply correction information to the recipient of the supply.

GST-registered underlying suppliers

In most situations, the marketplace rules for listed services apply regardless of the underlying supplier's GST registration status. This means that for any listed services provided through an electronic marketplace, it is the operator of the marketplace that is responsible for collecting and paying GST to Inland Revenue.

In limited circumstances, certain underlying suppliers can opt out of the marketplace rules. This enables them to continue accounting for GST on supplies of listed services they make through an electronic marketplace by including the supplies in their own GST returns. See "**Opting out of marketplace rules**".

GST-registered underlying suppliers will continue providing their own GST returns. They will need to keep a record of what supplies are made through an electronic marketplace and what supplies are made directly to their customers. This is because the supply of listed services made through an electronic marketplace is zero-rated under section 11A(1)(jc) and therefore must be included in the "Zero-rated supplies" box in the GST return. Other supplies will continue being accounted for in the usual way.

GST-registered underlying suppliers will purchase or acquire goods and services they use to make supplies of listed services through an electronic marketplace. The process for deducting input tax for these goods and services does not change. GST-registered underlying suppliers will continue to deduct input tax on their expenses in their own GST returns in the usual way.

Example 9: Accounting for sales and expenses associated with listed services as a GST-registered underlying supplier

Manjula provides ride-sharing/ride-hailing services through an electronic marketplace. He is registered for GST because he also drives a taxi for a taxi company, and the company includes GST in its pricing which Manjula is required to use. Manjula has notified the marketplace operator that he is registered for GST.

Manjula pays for goods and services that enable him to provide his ride-sharing/ride-hailing services such as fuel, vehicle maintenance, and insurance. The total cost of these goods and services for the month is $3,450 including GST. Manjula can recover the GST component of these costs as an input tax deduction by including these expenses in his GST return.

Manjula earns $2,500 from providing ride-sharing/ride-hailing services through the electronic marketplace for the month. He also earns $5,000 that month from his activities conducted off the electronic marketplace.

To complete his GST return, Manjula includes:

- $2,500 of sales in the "Zero-rated supplies" box on his GST return. These are sales of listed services that Manjula is treated as making to the marketplace operator. By including the sales in the "Zero-rated supplies" box, he will not have an output tax liability on these sales. Instead, the marketplace operator is required to account for output tax on these sales.
- $5,000 of sales in the "Total sales and income" box in his GST return. These are the sales from Manjula's activities conducted off the electronic marketplace.
- $3,450 of costs in the "Total purchases and expenses" box in his GST return. He will then calculate input tax deductions of $450.

Flat-rate credit

Sections 2(1) definition of "flat-rate credit", 3A(1)(d), 8C, 20(3)(de), 20(3N), 20(3JD), 20(4E), 25AAA and 60H of the GST Act; section 141(1) and schedule 7, part A, clause 3B of the Tax Administration Act 1994; sections CH 5B, CX 1B, DB 2(1)(ab) and (2B) of the Income Tax Act 2007

The flat-rate credit is a credit available to underlying suppliers that are not registered for GST. The flat-rate credit represents the average amount of GST that underlying suppliers, if they were registered, would be able to recover as input tax on goods and services they purchase and use to make supplies of listed services. The prescribed amount for the credit is set out in section 20(3N).

For listed services that are taxable accommodation, ride-sharing/ride-hailing services, or delivery services for food and/or beverages, the prescribed amount is 8.5% of the value of the listed services. This percentage was determined with reference to the average amount of input tax deducted by GST-registered taxi drivers and holiday homeowners. The 8.5% rate represents the average amount of input tax these suppliers would be able to recover if they were registered for GST and accounting for input tax deductions. It does not consider those with greater expenses and purchases than sales, as it was assumed that in such circumstances, the underlying supplier would prefer to be registered for GST and would do so voluntarily.

The flat-rate credit is not available to GST-registered underlying suppliers. This is because GST-registered underlying suppliers will be entitled to deduct input tax for their actual expenditure. The flat-rate credit is also not available to a person in their capacity as an employee. This is because the employee of a marketplace operator who performs listed services as part of their employment duties is not an "underlying supplier".

If an underlying supplier considers the flat-rate credit inappropriate for their circumstances, they may choose to register for GST voluntarily. This will enable them to deduct input tax for their actual expenditure, but also means that they will need to account for GST on all supplies they make from their taxable activities (including at the 0% rate on supplies of listed services made through an electronic marketplace when the marketplace operator is treated as the supplier of the services). This includes accounting for output tax on assets used principally for making taxable supplies in the event those assets are disposed of or the taxable activity ceases.

Operation of the flat-rate credit

Section 20(3)(de) requires marketplace operators that are treated as supplying listed services to deduct input tax for the flat-rate credit. The deduction is calculated based on the prescribed rate of the flat-rate credit for the relevant listed service that is set out in section 20(3N).

For taxable periods starting on or after 1 April 2025, marketplace operators can only deduct input tax for the flat-rate credit for underlying suppliers who have notified the marketplace operator that they are not registered for GST. To be notified, the marketplace operator needs to be directly alerted to the information. If an underlying supplier has not provided information about their GST registration status to the marketplace operator, the marketplace operator cannot deduct input tax for the flat-rate credit.

To claim a deduction under section 20(3)(de), section 20(2)(bb) requires the marketplace operator to have obtained the information referred to in section 60H(1) (being the underlying supplier's name, tax file number, and GST registration status). A deduction for the flat-rate credit would therefore be available if the underlying supplier's GST registration status, at the time of supply of the listed services, has been notified as not registered.

Marketplace operators are required to "pass on" the flat-rate credit to underlying suppliers. They must also notify, at least monthly, underlying suppliers of the total amount of flat-rate credit that has been passed on.

Example 10: Basic operation of the flat-rate credit on supplies of listed services

Henry provides short-term accommodation through an electronic marketplace. The marketplace operator is responsible for collecting GST on these supplies.

Henry notifies the marketplace operator that he is not a GST-registered person.

Josie books accommodation from Henry through the electronic marketplace for $200 plus GST for the stay. The marketplace operator collects GST of $30 on the supply of accommodation they are treated as making to Josie.

The marketplace operator applies the flat-rate credit scheme knowing Henry is not a GST-registered person. This results in the marketplace operator calculating:

- GST of $30 at 15% of the value of the supply of the accommodation, and
- the input tax deduction of $17 for the flat-rate credit at 8.5% of the value of the supply of the accommodation.

The marketplace operator is required to deduct input tax of $17 from the $30 of output tax payable to Inland Revenue. It is also required to pass on the $17 to Henry as a flat-rate credit.

The marketplace operator must also pay the remaining $13 to Inland Revenue as the net GST payable on the supply of accommodation.

To enable marketplace operators to apply the flat-rate credit, section 60H(1) requires underlying suppliers to notify the marketplace operator of their name, tax file number (IRD number), and GST registration status. Section 60H(2) requires underlying suppliers to notify marketplace operators of any subsequent change to their GST registration status, as this would affect entitlement to the flat-rate credit.

Section 60H(4) provides protection to marketplace operators that have been notified and relied on information from underlying suppliers if it is later discovered that the marketplace operator should not have passed on the flat-rate credit to an underlying supplier that was registered for, or liable to be registered for, GST. In such circumstances, absent the rules set out in section 60H(4), the marketplace operator could have a deficiency of tax equal to the amount of the input tax deducted for the flat-rate credit. Instead, section 60H(4) provides that the deficiency in tax attributable to a taxable period that arises because of the marketplace operator relying on the information provided by the underlying supplier is treated as a reduction in the total output tax allocated to the taxable period.

Information requirements for underlying suppliers entitled to the flat-rate credit

To enable marketplace operators to apply the flat-rate credit scheme, it is necessary for them to know whether the underlying supplier of listed services is a GST-registered person.

Underlying suppliers are therefore required under section 60H(1) and (2) to notify marketplace operators of their name, tax file number (IRD number), and GST registration status. Underlying suppliers are also required to notify marketplace operators of any changes to their GST registration status as soon as practicable (that is, if they become a GST-registered person or cease to be a GST-registered person).

If an underlying supplier had notified the marketplace operator that they were not registered for GST but does not notify a marketplace operator that they have since become registered for GST, this could result in the marketplace operator passing on the flat-rate credit which the underlying supplier is not entitled to. In these circumstances, the underlying supplier would be required to account for this as an output tax adjustment in its GST return. They may also be liable for shortfall penalties.

Conversely, if an underlying supplier ceases to be a GST-registered person but does not notify the marketplace operator of this change, the marketplace operator will not know to deduct input tax for the flat-rate credit and pass this on to them.

A person who has appropriate authority to act on behalf of an underlying supplier can also provide information about the underlying supplier's name, IRD number, and GST registration status.

Reporting the flat-rate credit

Marketplace operators are required to provide underlying suppliers with a statement showing the flat-rate credit passed on to them. Section 8C(6) requires this statement to be provided to underlying suppliers at least once a month. This could be based on calendar months or be provided monthly based on a date chosen by the marketplace operator or listing intermediary. If a marketplace operator wants to provide information about the flat-rate credit to underlying suppliers more frequently than monthly, this is also permitted.

This requirement is necessary to ensure that GST-registered underlying suppliers who receive the flat-rate credit (which they are not entitled to) will be alerted to it. GST-registered underlying suppliers are required to account for any flat-rate credit they receive as output tax in their own GST returns. This reverses the benefit of the flat-rate credit for GST-registered persons who will be deducting input tax for goods and services related to their supplies under the usual GST rules.

The statements to be provided by marketplace operators to underlying suppliers should show the total amount of the flat-rate credit passed on to them for the month (or, if the marketplace operator has chosen to provide a statement more frequently, for that period). The statement should show sufficient information that enables the underlying supplier to include, as an output tax adjustment, the amount of flat-rate credit they received in the correct taxable period. This information could be included in existing statements provided to underlying suppliers which show the total amount of consideration underlying suppliers are due, or have received, for services performed for the relevant period.

If a marketplace operator offsets other fees and charges for services it provided to an underlying supplier against the underlying supplier's flat-rate credit, the statement must still show the full amount of the flat-rate credit that was deducted as input tax by the marketplace operator in respect of the listed services made by the underlying supplier. In other words, the amount of the flat-rate credit reported to the underlying supplier should not be reduced or offset by other fees or charges.

Process for resolving under-deductions and over-deductions of input tax for the flat-rate credit

Section 25AAA applies when an operator of an electronic marketplace discovers that either too much, or too little, input tax has been deducted for the flat-rate credit. This might occur if, for instance, the supply of listed services is cancelled or the consideration for the supply changes after input tax for the flat-rate credit has already been deducted for the supply. In such circumstances, the flat-rate credit may have already been passed on to the underlying supplier.

Section 25AAA sets out the process that marketplace operators must follow when an over-deduction or under-deduction of the flat-rate credit is discovered.

For over-deductions, the marketplace operator must return an amount of output tax that is equal to the excess input tax deduction. If the marketplace operator has already passed the flat-rate credit on to the underlying supplier at the time of discovering the inaccuracy, the amount of the excess credit may be offset against another amount of flat-rate credit required to be passed on to the underlying supplier.

The rules in section 25AAA for over-deductions do not apply if the marketplace operator deducted input tax for the flat-rate credit for a supply by a GST-registered underlying supplier. If a GST-registered underlying supplier receives the flat-rate credit, they must account for this as an output tax adjustment in their GST return. Underlying suppliers are required to notify marketplace operators of their GST registration status, including any changes to their GST registration status, and marketplace operators should rely on this information when determining whether to apply the flat-rate credit scheme.

For under-deductions, the marketplace operator must deduct further input tax for the flat-rate credit. It must then pass this on to the underlying supplier. If the marketplace operator chooses, it can pass this additional amount on to the underlying supplier by offsetting it against other amounts owed by the underlying supplier to the marketplace operator (for example, commissions and other charges). In this situation, the amount that is offset must still be reflected in the monthly statement provided to the underlying supplier. The amount that is offset does not need to be shown separately on the statement from the other flat-rate credit amounts passed on for the relevant period – it is sufficient to include this amount in the total flat-rate credit passed on to the underlying supplier for that period.

The relevant adjustment of output tax or input tax to correct the inaccuracy must be made in the GST return for the taxable period in which the inaccuracy is discovered.

Example 11: Flat-rate credit adjustment when the supply of listed services is cancelled

An unregistered underlying supplier makes a supply of listed services through an electronic marketplace operated by a New Zealand-incorporated company that files its GST returns monthly. Time of supply for the listed services occurs in May 2024. The operator of the electronic marketplace calculates the flat-rate credit based on the value of the listed services and takes an input tax deduction for the flat-rate credit in its May 2024 GST return.

The supply is cancelled in October 2024 before the flat-rate credit is passed on to the underlying supplier (but after input tax has already been deducted for the flat-rate credit). The marketplace operator finds out about the cancellation (and therefore becomes aware that it has deducted too much input tax for the flat-rate credit for the cancelled supply) during that same month.

The marketplace operator returns an amount of output tax that is equal to the excess input tax deducted (in this case, the entire amount of the flat-rate credit that was first calculated for the supply) in its October 2024 GST return – October 2024 being the taxable period in which the marketplace operator became aware the supply was cancelled.

Requirement to pass on the flat-rate credit

Marketplace operators that have taken a deduction of input tax for the flat-rate credit must then pass this on to the underlying supplier. This is required by section 8C(3)(b)(ii).

The GST Act does not explicitly set out a timing requirement for marketplace operators to pass on the flat-rate credit to underlying suppliers that have purported to be unregistered persons. This ensures there is sufficient flexibility to allow marketplace operators to pass on the flat-rate credit to underlying suppliers alongside other funds due to the underlying supplier (for example, the fare for the ride-sharing/ride-hailing services or the amount of the booking for the accommodation). It also ensures that marketplace operators can choose not to pass on the flat-rate credit until the services are performed. This reduces the risk that a marketplace operator may pass on the flat-rate credit to an underlying supplier who ultimately does not end up providing the services to which the credit relates.

For the avoidance of doubt, section 8C(4B) provides that an amount of flat-rate credit passed on to an underlying supplier is not consideration for a supply of any goods or services by the underlying supplier.

Disclosure of GST registration status by Inland Revenue

The Commissioner can, despite the confidentiality rules in the Tax Administration Act 1994 (TAA), provide information about a person's GST registration status to a marketplace operator ensure the effective operation of the flat-rate credit scheme. The Commissioner can disclose this information under clause 3B, part A of schedule 7 to the TAA. Section 8C(5) sets out that if the Commissioner notifies a marketplace operator of an underlying supplier's GST registration status, the marketplace operator must act on this notification as soon as practicable.

Requirements of GST-registered persons who receive the flat-rate credit

If a GST-registered person receives the flat-rate credit they must account for this as an output tax adjustment in their GST return. The output tax adjustment is required for the taxable period in which the flat-rate credit was received. These requirements are set out in section 20(3JD) and 20(4E).

Example 12: GST-registered person receives flat-rate credit and must make an output tax adjustment to reverse the benefit

In completing her GST return for the period ending 31 March 2025, Poppy realises she received flat-rate credits from a marketplace operator related to listed services she supplied through an electronic marketplace. Poppy identifies this by reviewing the statement she receives from the marketplace operator that informs her of her total flat-rate credit for the month of March.

Poppy became a GST-registered person in February 2025. She forgot to notify the marketplace operator of this change in her circumstances. Poppy is keen to correct the error. The total amount of flat-rate credits Poppy received for February and March was $6,000.

To correct this error, Poppy must include $6,000 as an output tax adjustment in her GST return for the taxable period ending 31 March 2025. The $6,000 of output tax will be offset by any input tax deductions that Poppy can take for the period.

A GST-registered person who receives the flat-rate credit will also have a tax shortfall equal to the amount of the flat-rate credit they received. Section 141(1) of the TAA provides that a tax shortfall may arise because of a provision in an Inland Revenue Act. In these circumstances, a tax shortfall arises because of section 8C(3)(c)(ii), which means the person could be liable for shortfall penalties. Having a tax shortfall does not mean that penalties will be imposed automatically. The Commissioner may consider making an assessment of shortfall penalties when a person continuously misrepresents their GST registration status to claim amounts of the flat-rate credit that they are not entitled to.

Example 13: GST-registered person receives flat-rate credit resulting in a tax shortfall

Bradd is a registered person and provides taxable accommodation through an electronic marketplace. He has notified the marketplace operator that he is not a GST-registered person.

Bradd has a six-monthly taxable period. The only supplies Bradd makes are through an electronic marketplace. Between April 2024 and September 2024, Bradd makes supplies through the electronic marketplace equal to $46,000 excluding GST.

Bradd acquired goods and services that he used in making supplies through the electronic marketplace. The total value of these goods and services was $17,500 including GST. He deducted input tax of $2,282.60 in his GST return.

Because Bradd notified the marketplace operator that he was not a GST-registered person, the marketplace operator also passed on the flat-rate credit to Bradd for his listed services. The amount of flat-rate credit Bradd received totalled $3,910.

Bradd therefore has a tax shortfall equal to this amount and could be liable for a shortfall penalty.

If a GST-registered underlying supplier of listed services receives a flat-rate credit spanning multiple taxable periods (and therefore multiple GST returns), an output tax adjustment would need to be made in the GST return for each taxable period that the underlying supplier received the flat-rate credit. Section 20(4E) sets out the timing rules for the adjustments.

Example 14: GST-registered person receives flat-rate credit spanning multiple taxable periods

Marley is an underlying supplier of listed services who recently became registered for GST, and who prior to registering had notified the marketplace operator that he was not registered. Since registering for GST, he incorrectly receives the flat-rate credit because he has not yet notified the marketplace operator of his GST registration.

Marley has a six-monthly taxable period, providing GST returns for the periods covering 1 April to 30 September and 1 October to 31 March.

Marley receives the following flat-rate credits:

- $600 in February
- $400 in March
- $800 in April.

Marley becomes aware of his mistake and notifies the marketplace operator of his status as a GST-registered person at the end of April.

Marley is required to make an output tax adjustment of:

- $1,000 ($600 + $400) in his GST return for the taxable period ending 31 March, and
- $800 in his GST return for the taxable period ending 31 October.

Income tax implications of the flat-rate credit

Underlying suppliers who receive the flat-rate credit can choose to treat it as assessable income or excluded income.

If an underlying supplier treats the flat-rate credit as...	
...assessable income:	**...excluded income:**
• They will need to include the flat-rate credit received for an income year as "other income" in their income tax returns.	• They will not include the flat-rate credit in their income tax returns.
• They will be able to deduct their expenditure related to listed services provided through an electronic marketplace on a GST-inclusive basis for income tax purposes.	• They will need to deduct their expenditure related to listed services provided through an electronic marketplace on a GST-exclusive basis for income tax purposes.[1]

[1] This is because the flat-rate credit compensates underlying suppliers for GST on expenditure they would be able to deduct if they were a GST-registered person.

No specific election is required, and underlying suppliers make the choice to treat the flat-rate credit as assessable or excluded income by including the flat-rate credit as income (or not) in their income tax returns.

If an underlying supplier chooses to treat the flat-rate credit as excluded income, and they have incurred expenditure that partly relates to deriving income through an electronic marketplace and that partly relates to deriving income not through an electronic marketplace, apportionment of GST-inclusive and GST-exclusive expenditure will be required. Further information about how to apportion expenditure in such cases is available in the following publications:

- QB 25/01: Income tax – Which rules apply if I rent out my home, part of my home, or a separate dwelling on my property as short-stay accommodation?
- QB 25/02: Income tax – Which rules apply if I have a dwelling I sometimes rent out as short-stay accommodation and also sometimes use privately?
- QB 25/03: Income tax – How do the mixed-use asset rules apply if I provide short-stay accommodation?
- QB 25/04: Income tax – How do the standard tax rules apply if I provide short-stay accommodation?
- QB 25/05: Income tax – If property held in trust is rented out for short-stay accommodation, who declares the income and what deductions can be claimed?

For marketplace operators and listing intermediaries:

- Payment of the flat-rate credit to underlying suppliers is not deductible for income tax purposes.
- Input tax deductions for the flat-rate credit do not give rise to assessable income.

Effect of the flat-rate credit when person becomes registered for GST

If a person becomes registered for GST, for the period prior to GST registration, assets that they used to make supplies of listed services will be treated as having a non-taxable use for the apportionment and adjustment rules.

Once registered for GST, the person may choose to perform an adjustment at the end of their adjustment period (their balance date) which reflects the new percentage of use that relates to making taxable supplies – if this new percentage is a permanent change that is likely to be maintained for the foreseeable future.

Inland Revenue has published a special report on recent changes to the apportionment and adjustment rules.[4] Further information is also available on Inland Revenue's website (keyword search: GST apportionment).

Opting out of marketplace rules

Sections 60C(2BB), (2BC), (2BD), (2BE), (2BF) and (3D), 60H(3) and 85D of the GST Act

Marketplace rules will generally treat the operator of an electronic marketplace that another person makes supplies through (the underlying supplier) as the supplier. This means that the marketplace operator becomes responsible for accounting for GST on these supplies.

Marketplace rules may not be appropriate for larger suppliers that already have established accounting systems and practices in place for managing compliance with their GST obligations. This is because marketplace rules could require these taxpayers to change their existing accounting systems and practices which would increase compliance costs for limited benefit to tax collection and tax administration.

The marketplace rules for listed services therefore include provisions that enable certain underlying suppliers to opt out of the rules. In certain circumstances, an underlying supplier can opt out of marketplace rules by notifying the marketplace operator that they will remain responsible for their own GST obligations. This is available to underlying suppliers that are required to maintain a monthly or two-monthly taxable period, which is those that make taxable supplies of more than $500,000 in a 12-month period.

Some underlying suppliers may also be able to enter into an opt-out agreement with the marketplace operator. If an agreement was in place, these underlying suppliers would continue being responsible for their own GST obligations. Agreements can be entered into provided the underlying supplier meets specific criteria. If an underlying supplier stops meeting the criteria for an opt-out agreement, the agreement must be withdrawn. In these circumstances, the underlying supplier should notify the marketplace operator they no longer meet the criteria to opt out of the marketplace rules.

Underlying suppliers who have opted out of the marketplace rules will need sufficient information from the marketplace operator so they can correctly account for output tax on the supply. This will include the price, inclusive of any commissions, mark-ups or other fees due to the marketplace operator for their services, that the recipient of the supply will pay to the marketplace operator directly. This means marketplace operators will need to provide underlying suppliers with this information.

Suppliers over $500,000 in a 12-month period

Underlying suppliers that are required to maintain a two-month or one-month taxable period under section 15 can unilaterally opt out of the marketplace rules by notifying the marketplace operator that they choose to be liable for the payment of GST on supplies they make and will continue to remain responsible for all obligations under the GST Act.

This opt-out is only available to underlying suppliers who are required to maintain a monthly or two-monthly taxable period for their GST returns (that is, they are required to provide GST returns on a monthly or two-monthly basis). This means an underlying supplier who chooses to provide GST returns on this basis but does not exceed at least $500,000 in taxable supplies in a 12-month period is unable to opt out of the marketplace rules under this ground.

4 See *Special report on GST apportionment and adjustment rules* published by Policy and Regulatory Stewardship, Inland Revenue (April 2023) available at: https://www.taxpolicy.ird.govt.nz/publications/2023/2023-sr-gst-apportionment-and-adjustment-rules

This opt-out ground is further restricted to **non-natural persons** only under section 60C(2BF)(a). This is to mitigate a potential integrity risk that a natural person could purport to be eligible to opt out of the rules under this ground, despite not meeting the criteria, and the marketplace operator having to accept this, ultimately resulting in no GST being collected on supplies made by this person.

If an underlying supplier no longer meets the criteria under this opt-out ground, they must inform the marketplace operator that they are no longer eligible to remain responsible for their own GST obligations. This will enable the marketplace operator to apply the marketplace rules, which will treat them as the supplier of the services and will therefore result in them having to collect and return output tax and provide taxable supply information.

Marketplace operators will not be required to verify that an underlying supplier meets this criterion. They will be able to rely on information they receive, by election, from the underlying supplier. This information must be retained by the marketplace operator in accordance with the general record keeping requirements for GST set out in section 75. This provides that records must generally be kept for seven years following the end of the taxable period to which they relate.

Suppliers eligible to enter agreements to opt out of marketplace rules

An underlying supplier can enter an opt-out agreement with a marketplace operator provided they:

- meet the requirements set out in a determination made by the Commissioner, or
- provide taxable accommodation and meet the 2,000-night threshold.

Criteria set out in a determination issued by the Commissioner

The Commissioner has the power under section 60(2BC) to issue determinations that set out the circumstances in which a person can enter into an opt-out agreement.

Before making a determination, the Commissioner is required to have regard to several factors. These factors, set out in section 60(2BD), are the compliance costs that would arise for underlying suppliers in making changes to their accounting systems and practices, and the size, scale, and nature of the services and activities undertaken by underlying suppliers.

The Commissioner has issued determination **DET 25/01: GST on supplies through electronic marketplaces – hostel and motel opt-out agreement criteria**. DET 25/01 replaced an earlier version of this determination (DET 24/02), which expired on 31 March 2025. At the time of publication of this special report, no other determinations have been issued.

The 2,000-night threshold

Underlying suppliers that supply taxable accommodation through electronic marketplaces may be able to enter an opt-out agreement provided they list more than 2,000 nights of accommodation on an electronic marketplace in a 12-month period. This also includes when the underlying supplier has a reasonable expectation that they can meet this requirement in the 12-month period.

Example 17: Reasonable expectation for more than 2,000 nights

Harris Hotels Ltd operates a multinational hotel chain. It runs a hotel business in Auckland, Christchurch, and Wellington.

Each hotel has 100 rooms. The rooms are available all-year round and are advertised on an electronic marketplace.

Harris Hotels Ltd therefore has a total of 109,500 nights of accommodation available through electronic marketplaces. This is calculated based on 300 rooms available for 365 nights.

It is not possible to aggregate accommodation nights across multiple electronic marketplaces for these purposes. This means that if a person has 1,000 nights available through one electronic marketplace and 1,500 nights available through another electronic marketplace, they would not be able to enter into an opt-out agreement under this test.

Example 18: More than 2,000 nights across multiple marketplaces – not eligible

Will and Nicole own six properties that they lease for short-term accommodation through multiple electronic marketplaces.

Five properties are available for rent all-year round through an electronic marketplace, Accommodation4U. This equates to 1,825 nights of accommodation available through Accommodation4U (5 × 365 nights).

The other property is available through another electronic marketplace. It is not available all-year round so Will and Nicole choose for this not to be advertised on Accommodation4U.

This means Will and Nicole are unable to enter an opt-out agreement with the marketplace operator for Accommodation4U based on having more than 2,000 nights of accommodation available in a 12-month period through the electronic marketplace.

Example 19: More than 2,000 nights on one electronic marketplace – eligible on other marketplaces

Heyes Hotels Co lists rooms available for rent through an electronic marketplace, A Co. It has 40 rooms available across its two New Zealand locations and these rooms are available all-year round. All rooms are listed through A Co. It therefore satisfies the criteria to enter into an opt-out agreement with A Co.

The owners of Heyes Hotels Co want to list rooms on another electronic marketplace, B Co. It wants to trial providing accommodation through B Co and is not able to commit to listing more than 2,000 nights in a 12-month period through B Co until it sees whether B Co improves Heyes Hotels Co's bookings.

Heyes Hotels Co can enter an opt-out agreement with B Co because it satisfies the 2,000-night criterion on another electronic marketplace, A Co.

Example 20: 2,000-night criterion not satisfied – nights available exceed 2,000 in aggregate, but not on an individual electronic marketplace

Lucy and Richard have six investment properties – three in Wanaka and three in Waiheke. The properties are available for short-term rental accommodation.

The Wanaka properties are available for booking through an electronic marketplace, Sam's Stays Ltd. The Waiheke properties are available for booking through another electronic marketplace, Ben's Baches Co.

All properties are available all-year round and in aggregate, the 2,000-night threshold is satisfied. However, because the properties are listed on separate electronic marketplaces, Lucy and Richard are not eligible to enter an opt-out agreement with the operators of Sam's Stays Ltd or Ben's Baches Co.

Marketplace operators are not required to monitor whether underlying suppliers that have entered into an opt-out agreement with them list more than 2,000 nights of accommodation available through them in each 12-month period.

These agreements would apply for a 12-month period. This can be any 12-month period and does not need to coincide with a calendar year. However, if an underlying supplier does not have a reasonable expectation that they will list more than 2,000 nights of accommodation on one electronic marketplace for a later 12-month period, they may not renew their agreement to opt out of the electronic marketplace rules under this ground.

If a person is a member of a group of companies, the 2,000-night threshold can be applied on a group basis. This means that, provided the group of companies satisfies the 2,000-night threshold, all members of the group can individually enter into an opt-out agreement with marketplace operators. This is provided for in section 60C(2BE). The definition of "group of companies" that applies for these purposes refers to the definition set out in the Income Tax Act 2007 which requires common voting interests of at least 66%.[5]

When determining what constitutes a "night" under this test, nights should be determined on a per listing basis. This means that each night a listing is made available to book on an electronic marketplace counts as one night under this test.

5 See section IC 3 of the Income Tax Act 2007.

Example 21: What constitutes a "night" under the 2,000 nights test

Sam

Sam owns a five-bedroom house in Wanaka. The way the house is configured means that two of the bedrooms have their own ensuite and kitchenette. Both bedrooms have their own self-contained accessway down each side of Sam's home, and the bedrooms can be locked from the outside to shut them off from the main house. When Sam is living in the house, he lists these two rooms as separate accommodation on an electronic marketplace, A Co. If Sam lists both of these rooms as available to book year-round, this would total 730 nights of accommodation available per annum under the 2,000 nights test (365 × 2 = 730).

Shanae

Sam's neighbour Shanae owns the five-bedroom house next door to Sam. Shanae's house is configured in the same way as Sam's (two of the bedrooms have their own separate ensuite, kitchenette and self-contained accessway). For 300 days of the year, Shanae lists both rooms separately on A Co. (which totals 600 nights under the 2,000 nights test).

Shanae decides to travel to Europe for the summer and is away for 65 days. During the time that Shanae is away, she decides to list the entire house on A Co as one listing. This constitutes 65 nights of accommodation being made available. It is not relevant that two of the bedrooms provide additional facilities and can be used in a self-contained manner. The decisive factor is how many nights of accommodation Shanae has made available through the electronic marketplace, which is calculated on a per listing basis.

Further requirements for opt-out agreements

Provided underlying suppliers meet the criteria for an opt-out agreement as set out above, and the marketplace operator agrees to an opt-out, section 60C(2BB) contains further requirements before an agreement is valid. Under these rules:

- the documentation provided to the recipient of the services must identify the supply as being made by the underlying supplier and not the electronic marketplace, and
- there must be an agreement, with that agreement being recorded in a document, that the underlying supplier is liable for the payment of tax for supplies of listed services and will continue to remain responsible for their tax obligations under the GST Act. This includes the requirement to provide the recipient with taxable supply information, if required, and providing GST returns and paying GST to Inland Revenue.

If these requirements are not satisfied, the marketplace operator will be treated as the supplier of listed services and will therefore be required to account for GST on these supplies.

Transitional provision for supplies of listed services

Section 85D applies to enable eligible underlying suppliers to enter into an agreement with marketplace operators, or notify marketplace operators, that they are opting out of the marketplace rules. This provision allows eligible underlying suppliers to opt out of the marketplace rules before they come into effect on 1 April 2024.

The Commissioner also has the power, from 1 April 2023 to issue determinations setting out criteria a person must meet if they wish to opt out of the marketplace rules but do not meet the statutory criteria.

Listing intermediaries

Section 60CB of the GST Act

It is especially common for owners of holiday homes to use a property manager or agent[6] to list taxable accommodation in those properties on electronic marketplaces. In this situation, it is not uncommon for the host to have no relationship with the operator of the electronic marketplace on which the accommodation is listed or advertised. When this is the case, the GST rules for electronic marketplaces may not work appropriately on their own. This is because the marketplace operator might not have

6 "Agent" is used here in a more colloquial sense, rather than in a precise legal sense. For instance, it does not necessarily refer to someone who is an agent for the purposes of section 60 of the GST Act, but rather has a broader meaning in this context referring to anyone who might list taxable accommodation on an electronic marketplace on behalf of the host.

any information about the host that is necessary for administering the flat-rate credit scheme (such as the host's name and GST registration status) and it may be difficult for the marketplace operator to obtain and hold this information, given the absence of both a contractual relationship and direct dealings with the host. This may make it impractical for the marketplace operator to administer the flat-rate credit scheme for such hosts.

When the property manager or agent has a contractual relationship with an operator of an electronic marketplace to list or advertise the services on the marketplace, the agent (referred to as a "listing intermediary") will be responsible for all requirements related to the flat-rate credit (instead of those obligations being on the marketplace operator). As explained below, they will also be treated as making a zero-rated supply of the accommodation provided by the host to the marketplace operator, unless they are able to agree with the marketplace operator that they are liable for GST at the 15% rate on supplies of taxable accommodation.

Listing intermediary definition

A "listing intermediary" is defined in section 60CB(8) as a registered person who lists taxable accommodation on an electronic marketplace on behalf of a host who makes those supplies through the marketplace.

The definition of "listing intermediary" requires that the person enters into an agreement with the marketplace operator to list or advertise the accommodation provided by the host. A listing intermediary may also provide other services to hosts (such as property management services), but the listing intermediary definition does not require this.

An agent who lists taxable accommodation on an electronic marketplace on behalf of a host but who does not have an agreement in their own name with the marketplace operator to list or advertise the services on the marketplace does not meet the definition of a "listing intermediary". Therefore, they are not subject to the requirements on listing intermediaries (namely, the various requirements related to the flat-rate credit, which would normally be the responsibility of the marketplace operator but become the responsibility of a listing intermediary when they are interposed between a host providing taxable accommodation and a marketplace operator). In this circumstance, the agent will instead provide information to the marketplace operator about the host, such as the host's GST registration status and bank account information.

Example 22: Property manager meets listing intermediary definition

Andraya uses the services of a property manager to manage her holiday home and advertise it on an electronic marketplace for short-stay accommodation. The property manager is registered for GST.

The property manager has an agreement in its own name with the operator of the electronic marketplace to list accommodation provided in multiple properties on the electronic marketplace. Aside from the addresses of the properties listed on the marketplace, the marketplace operator does not know anything about Andraya or any of the other owners of the properties listed on the marketplace by the property manager.

The property manager meets the definition of a listing intermediary.

Example 23: Person is not a listing intermediary

Willow has a holiday home in the Coromandel that she would like to rent out for the summer on Rent-A-Holiday-Home, a prominent electronic marketplace for short-stay accommodation. Willow is aware that her next-door neighbour, Callan, has an account on Rent-A-Holiday-Home that he sometimes uses to rent his own holiday home out for short-stay accommodation. Neither Willow nor Callan are registered for GST.

Willow is not a confident user of computers and smartphones, so she asks Callan if he can create an account on Rent-A-Holiday-Home for her and list the Coromandel holiday home on Rent-A-Holiday-Home as available for short-stay accommodation guests to book over the summer.

Callan creates an account on Rent-A-Holiday-Home for Willow and lists Willow's Coromandel holiday home as available to book over the summer. Even though the email address provided to Rent-A-Holiday-Home is Callan's secondary email address (rather than Willow's email address), the contract entered into with the marketplace operator to list the accommodation in the Coromandel holiday home is in Willow's name, not Callan's.

Callan is not a listing intermediary. Callan provides details of Willow's GST registration status (unregistered) and her bank account details to Rent-A-Holiday-Home so Rent-A-Holiday-Home can pay her the flat-rate credit.

Default rules for listing intermediaries – deeming of three separate supplies

Section 60CB(2) applies when a listing intermediary is interposed between a host providing taxable accommodation and an operator of an electronic marketplace. The listing intermediary is "interposed" between the host and the operator of the electronic marketplace on which the accommodation is listed if the marketplace operator only deals with the listing intermediary in relation to the accommodation listed (and not directly with the host). In this circumstance, it is likely that the marketplace operator does not hold any information about the host except for the address of the property the accommodation is provided in.

Under section 60CB(2), the supply of the accommodation is treated as three separate supplies:

- A supply from the host to the listing intermediary. This supply is zero-rated under section 11A(1)(jd) if the host is a registered person.
- A supply from the listing intermediary to the marketplace operator, which is also zero-rated under 11A(1)(jd). This zero-rated supply does not create a requirement for the listing intermediary to provide taxable supply information to the marketplace operator for the supply. It does however mean that the listing intermediary should include the value of this supply and all other zero-rated supplies that they make (or are deemed to make) in the "Zero-rated supplies" box in their GST return. The value of all such supplies also counts towards the person's total supplies for determining whether they exceed the GST registration threshold.
- A supply from the marketplace operator to the guest, which is subject to GST at the standard 15% rate. This means the default setting for output tax when a listing intermediary is interposed between the host and an operator of an electronic marketplace is that the liability for output tax at the 15% rate remains with the marketplace operator (just as it would if the listing intermediary was not involved in the supply).

Application of flat-rate credit provisions

Section 60CB(5) provides that, under the provisions related to the flat-rate credit, the listing intermediary is treated as though they are the operator of the electronic marketplace through which the supply of listed services is made, and must meet all the requirements placed on the operator for the flat-rate credit under those provisions for that supply. This means that when a listing intermediary is interposed between a host providing taxable accommodation and an operator of an electronic marketplace, all requirements related to the flat-rate credit for that supply are imposed on the listing intermediary – including the requirement to deduct input tax for the flat-rate credit and to pass it on to the host, and to provide a statement, at least monthly, to the host showing the amount of flat-rate credit passed on. The Commissioner can also provide information about an underlying supplier's GST registration status to a listing intermediary for the purposes of the flat-rate credit scheme. See "**Flat-rate credit**" for a full explanation of these provisions.

Treatment of services supplied by listing intermediary directly to guests

In addition to listing or advertising taxable accommodation on an electronic marketplace on behalf of hosts, some listing intermediaries may provide property management services to these hosts. In this situation, it is not uncommon for the listing intermediary to structure its contracts so that services such as cleaning and linen hire are supplied to guests staying at the property (rather than being supplied to the host), for which the guests pay a fee. The fact that there is a separate fee for the listing intermediary's services on top of the price of the accommodation itself may not be apparent because the marketplace may take and display just one bundled price for the package of services (being taxable accommodation and the listing intermediary's services).

Under the pre-1 April 2024 GST rules, the listing intermediary (if registered for GST) would have already been accounting for and paying GST to Inland Revenue on its services. However, if the fee charged for the listing intermediary's services is not known to the marketplace operator and cannot be distinguished from the price of the accommodation, having the marketplace operator account for output tax on the supply of accommodation and the listing intermediary account for output tax on the supply of its services would likely result in double taxation of the listing intermediary's services.

To address this issue, section 60CB(3) provides that when section 60CB(2) applies to a supply of listed services, a supply of other services by the listing intermediary to the guest through the electronic marketplace is treated as two separate supplies as follows:

- a supply from the listing intermediary to the operator of the electronic marketplace that is zero-rated under section 11A(1)(jd), and
- a supply by the marketplace operator that is subject to GST at the standard 15% rate.

The above rule only applies if section 60CB(2) applies. As discussed below, there may be situations when a listing intermediary is liable for output tax on a supply of taxable accommodation, in which case section 60CB(2) would not apply. In that situation, any services the listing intermediary supplies directly to guests through the electronic marketplace will retain their GST treatment under the normal GST rules, rather than being subject to the rule in section 60CB(3). This means, rather than being treated as making a zero-rated supply of those services to the marketplace operator (and the marketplace operator being treated as supplying those services to the guest), the listing intermediary's supply to the guest is a single standard rated supply as per the pre-1 April 2024 rules.

If the listing intermediary **is** treated as making a zero-rated supply of the services to the marketplace operator, they are not required to provide taxable supply information to the marketplace operator in respect of this supply.

Because the "other" services supplied by the listing intermediary to the guest (that the listing intermediary is treated as supplying to the marketplace operator) are not "listed services", the provision of these services to the guest does not affect the calculation of the flat-rate credit that the listing intermediary is required to deduct input tax for in its GST return and then pass on to the host. In other words, the amount of flat-rate credit required to be deducted and passed on is based only on the value of the accommodation provided by the host, and does not include the value of the other services provided by the listing intermediary to the guest.

Example 24: Default rules for listing intermediaries

Gordon uses the services of a listing intermediary to manage his property and list it on several electronic marketplaces for short-stay accommodation. Gordon is not registered for GST. The listing intermediary is registered for GST for its property management activity.

Gordon has an agreement with the listing intermediary that his property will be rented out for no less than $100 per night.

Harriet uses an electronic marketplace to book accommodation in Gordon's property. Harriet pays a total of $150 plus GST for one night's stay in Gordon's property. This includes $100 for the accommodation, and $50 for services supplied to Harriet by the listing intermediary.

The marketplace operator accounts for GST on the supply. It provides Harriet with taxable supply information.

The listing intermediary is deemed to make a supply of the accommodation provided by Gordon to the operator of the electronic marketplace. It is also treated as making a supply of its own services (that it contractually supplies to Harriet) to the marketplace operator. Both deemed supplies are zero-rated, meaning the listing intermediary has output tax of zero for the $150 of services it is treated as supplying to the operator of the electronic marketplace. This is because the marketplace operator has accounted for output tax on these supplies at the standard GST rate of 15%.

The listing intermediary is responsible for calculating the flat-rate credit for Gordon. It calculates this based on the value of the accommodation of $100. It will be responsible for providing Gordon with a statement, at least monthly, showing the flat-rate credit that Gordon received from the listing intermediary.

When listing intermediary is treated as supplier of taxable accommodation

Provided certain conditions are met, a listing intermediary can agree with an operator of an electronic marketplace that they are liable for output tax on accommodation supplied through the electronic marketplace. The agreement between the listing intermediary and the marketplace operator must be recorded in a document.

To be entitled to seek such an agreement, the listing intermediary must:

- be a New Zealand tax resident
- list the accommodation provided by the host on not just one, but multiple electronic marketplaces, and
- enable or facilitate the supply of the accommodation using an electronic system that can facilitate and manage guests' bookings automatically. For example, such an electronic system might include an application programming interface (API) that transmits data or information between the electronic marketplace and the listing intermediary's systems, or property management software that the listing intermediary uses to manage bookings taken via multiple electronic marketplaces.

The intention of the second and third requirements above is to limit the ability for a listing intermediary to obtain such an agreement with a marketplace operator to situations where the listing intermediary is in some ways similar to an operator of an electronic marketplace. The person might even be an operator of an electronic marketplace in certain scenarios, such as when they operate their own website or app through which guests can book taxable accommodation provided by a host. When a person is both a listing intermediary for some supplies of taxable accommodation and a marketplace operator for other supplies (and would therefore be liable for output tax on those other supplies), the rules allow the person the option of accounting for and paying output tax on supplies for which they are a listing intermediary, subject to the marketplace operator's agreement with this arrangement.

Section 60CB(7) provides that the effect of such an agreement is that the listing intermediary is treated as though they are the marketplace operator for several key provisions in the GST Act related to listed services. This includes section 60C(2)(ab), which is the rule that treats taxable accommodation as supplied by the operator of the electronic marketplace through which the supply of services is made, provided those services are performed, provided or received in New Zealand.

In addition to being treated as the operator of the electronic marketplace for the purposes of section 60C(2)(ab) and the provisions related to the flat-rate credit, the listing intermediary is also treated by section 60CB(7) as though it is the operator of the electronic marketplace for:

- Section 25AAA – when a listing intermediary is interposed between a host and an operator of an electronic marketplace, the listing intermediary must apply the rules for correcting over-deductions or under-deductions of input tax for the flat-rate credit when such inaccuracies are discovered.
- Section 60(1C) – the host is treated as making a supply of listed services to the listing intermediary, which is zero-rated if the host is a registered person, and the listing intermediary is treated as making a standard rated supply of the same services to the guest.
- Section 60C(3B) and (3C) – the act of a listing intermediary recovering or deducting an amount from a payment due to the host and using this amount to satisfy its output tax liability for a supply it is treated as making does not give rise to any further GST implications.
- Sections 60C(2BB), (2BE), (2BF) and 60H – the various references to the "operator of the electronic marketplace" or "operator" throughout section 60H and in the rules for underlying supplier opt-outs should instead be read as referring to the listing intermediary. Under section 60H, this applies not just for the subsections related to the provision of information by underlying suppliers for the flat-rate credit, but also for the notification rule for unilateral opt-outs (section 60H(3)) when the underlying supplier is able to unilaterally opt out of the electronic marketplace rules because their total annual supplies are more than $500,000.
- Section 85E – when the listing intermediary is liable for output tax on supplies of taxable accommodation under section 60CB(7), it is eligible to apply the transitional rule for contracts for taxable accommodation entered into before 1 April 2024, provided certain conditions are met.

When section 60CB(7) applies, the marketplace operator is relieved of all liability under the GST Act for the supply, except for the provision of taxable supply information as discussed below. This means the listing intermediary is liable to account for and pay output tax to Inland Revenue on supplies of taxable accommodation made on or after 1 April 2024.

Providing taxable supply information

Whenever a listing intermediary is interposed between a host and an operator of an electronic marketplace in the supply of taxable accommodation to a guest, the marketplace operator is by default treated as the supplier of the services for the provision of taxable supply information and supply correction information (even if the listing intermediary is liable for output tax on the supply under section 60CB(7)). This means:

- the marketplace operator (not the listing intermediary) is required to issue taxable supply information to the guest under section 19NB, including when section 60CB(7) applies to treat the listing intermediary as making a supply of the services to the guest that is subject to the standard GST rate of 15%, and
- the "supplier's" details (such as name and GST registration number) the marketplace operator is required to include in the taxable supply information are their own, and not those of the listing intermediary or the host.

However, when a listing intermediary is liable under section 60CB(7) for output tax on supplies of taxable accommodation that they list on an electronic marketplace, the listing intermediary and the marketplace operator may agree that the listing intermediary (not the marketplace operator) is responsible for issuing taxable supply information and supply correction information to the recipient of the accommodation. This agreement must be recorded in a document. If the parties agree to this arrangement, the "supplier's details" included in the information must be those of the listing intermediary, not the marketplace operator.

Example 25: Listing intermediary is responsible for output tax; no agreement regarding provision of taxable supply information

Sally uses the services of a listing intermediary to manage her property and list it on multiple electronic marketplaces to maximise her advertising exposure and therefore the number of nights on which the property is booked throughout the year. Sally is not registered for GST. The listing intermediary is registered for GST for its property management activity.

Iona uses one of the electronic marketplaces on which Sally's property is advertised to book the property for one night. Iona pays a total of $200 plus GST. This includes $120 for the accommodation and $80 for services supplied to Iona by the listing intermediary.

The listing intermediary has a written agreement with the operator of the electronic marketplace that the listing intermediary, rather than the marketplace operator, is liable for GST on any supplies of taxable accommodation that the intermediary lists on the electronic marketplace. This means the listing intermediary (not the electronic marketplace operator) is the supplier of the accommodation for GST purposes and has the responsibility for returning output tax on the supplies at the 15% GST rate.

The listing intermediary accounts for output tax on the total value of the services supplied to Iona of $200.

The listing intermediary is also responsible for calculating the flat-rate credit for Sally. It calculates this based on the value of the accommodation of $120. It is responsible for providing Sally with a statement, at least monthly, which shows the flat-rate credit that Sally received from the listing intermediary.

Even though the marketplace operator is not liable for output tax on the supply of accommodation, it is still responsible for providing taxable supply information to Iona. This is because the marketplace operator and the listing intermediary have not agreed in writing that the listing intermediary is responsible for providing taxable supply information and supply correction information. The marketplace operator includes its own name and GST registration number in the taxable supply information provided to Iona.

Opt-out rules for hosts

A host who is eligible to opt out of the electronic marketplace rules (because more than 2,000 nights of accommodation they provide is listed on an electronic marketplace in a 12-month period, or because their taxable supplies in a 12-month period exceed $500,000) can still opt out or seek to opt out even if they use a listing intermediary to list the accommodation on the electronic marketplace. In this circumstance, the listing intermediary must notify the marketplace operator on the host's behalf if the host is unilaterally opting out of the rules. If an opt-out agreement with the marketplace operator is required, the listing intermediary may need to liaise between the host and the marketplace operator so the two parties can enter into an opt-out agreement.

Even if a listing intermediary has an agreement with the marketplace operator that they are liable for output tax on the supplies of accommodation that they list on the marketplace, a host that the listing intermediary acts for who wishes to opt out of the rules to remain responsible for their own GST obligations may still be able to do so. In this situation, the host must either notify the listing intermediary they are opting out (if they are opting out because their taxable supplies in a 12-month period exceed $500,000),[7] or enter into an opt-out agreement with the listing intermediary (if they are seeking to opt out because they meet the "listing more than 2,000 nights of accommodation" criterion).

7 In this circumstance, the listing intermediary is not required to notify the marketplace operator that the host is opting out of the rules. The listing intermediary is only required to notify the marketplace operator that the host is unilaterally opting out if the marketplace operator (not the listing intermediary) would have been liable for output tax on the supplies of taxable accommodation had the host not opted out.

Optional accounting rule for taxable accommodation

Sections 19DB and 20(4)(e) of the GST Act

The default time of supply rule in section 9(1) provides that a supply of goods and services is deemed to take place at the earlier of the time an invoice is issued or the time any payment is received, in respect of that supply.

This usually means that, if a supplier of goods and services accounts for GST on the invoice basis, the supplier must account for GST at the earlier of when a payment is received, or an invoice is issued, for the goods and services. If the supplier instead uses the payments basis, generally they must account for GST to the extent to which payment is received for the supply.

These timing rules may create several problems in the taxable accommodation context. For example, when a GST-registered host has opted out of the marketplace rules to remain responsible for their own GST obligations, the guest's payment may be received and held by the marketplace operator. Therefore, the marketplace operator may have triggered time of supply for the host, with the host potentially being unaware of this. Second, even if the host is aware that time of supply has occurred, they may not have sufficient cash available to pay their GST liability.

To address these issues, an optional accounting rule in section 19DB provides that operators of electronic marketplaces, listing intermediaries, and hosts (as applicable) may choose to account for output tax (and deduct input tax for the flat-rate credit, if applicable) on a supply of taxable accommodation through an electronic marketplace up to seven days after the performance of the services is completed (in practice, this would be up to seven days after the guest's check-out date).

If a marketplace operator, listing intermediary, or host chooses to use this rule, it does not affect when the time of supply is deemed to occur under section 9.

Supplies covered by optional accounting rule

Section 19DB applies when a registered person (which may be marketplace operator, a listing intermediary, or the host, depending on the circumstances) is required to account for, as applicable:

- output tax on a supply of taxable accommodation made through an electronic marketplace
- input tax for a flat-rate credit that is required to be passed on to the host.

Section 19DB also applies to other services that are closely connected to the supply of taxable accommodation if they are advertised, listed, or otherwise made available through an electronic marketplace.

Under section 19DB, the registered person may choose to account for output tax (and/or input tax for the flat-rate credit) in or before the taxable period that includes the date that is seven days after the performance of the services is completed. In practice, the "date that is seven days after the performance of the services is completed" would be the date that is seven days after guest check-out occurred.

Rule is optional to apply, including on supply-by-supply basis

The accounting rule in section 19DB is optional to apply for any given supply covered by the section, meaning the registered person could choose to apply the rule to some supplies of taxable accommodation made through an electronic marketplace but would not have to apply it to all such supplies.

If a person chooses to apply the rule, it will be applied by accounting for GST on the relevant supplies in the taxable period in which the performance of the services is completed, or in an earlier taxable period (such as the taxable period in which the guest checked in to or checked out of the accommodation, if different to the taxable period that includes the date that is seven days after the check-out date). The person does not need to notify Inland Revenue of their choice to apply the rule, but they must keep evidence of their choice for a minimum period of seven years in accordance with the record-keeping rules in the GST Act.

If the person chooses to apply the optional rule, output tax on the supply is attributed to the taxable period in which the person chooses to account for it (see section 20(4)(e)). This taxable period must not be later than the taxable period that includes the date that is seven days after the performance of the services is completed. If the person is liable for both output tax on a supply and to meet requirements relating to the flat-rate credit for that supply, they must account for output tax and take an input tax deduction for the flat-rate credit on the supply in the same taxable period.

If the person chooses not to apply the optional accounting rule, they would account for GST on the supply according to their normal accounting basis.

Example 26: Electronic marketplace chooses to account for GST on check-in date

Max books accommodation at a holiday home in Queenstown for two nights through Willow's Hideaways Ltd, an electronic marketplace. The host has not opted out of the electronic marketplace rules.

Willow's Hideaways Ltd chooses to use the optional rule by accounting for GST on the supply in the taxable period that includes Max's check-in date.

Example 27: Host makes supplies through multiple marketplaces

Hotel Co makes supplies of accommodation through two electronic marketplaces: electronic marketplace A (EMA) and electronic marketplace B (EMB). Hotel Co is registered for GST and has elected to account for GST on the invoice basis. Hotel Co has notified the marketplace operators it will remain responsible for its own GST obligations because it makes supplies of more than $500,000 in a 12-month period.

When guests book accommodation with Hotel Co through EMA, the guest pays the marketplace operator directly and not Hotel Co. In this situation, Hotel Co chooses to apply the optional rule, allowing them to account for GST on the supply up to seven days after the performance of the services is completed (that is, seven days after the guest's check-out date). Hotel Co includes these supplies in its GST returns in accordance with the optional rule, based on when EMA remits the customer's payment to Hotel Co (which is never more than seven days after the check-out date).

For accommodation booked with Hotel Co through EMB, the guest pays Hotel Co directly (Hotel Co separately pays EMB's charges). In this situation, Hotel Co chooses to account for GST on the supplies according to the normal rules (that is, it accounts for GST in the taxable period in which time of supply occurred, being the earlier of when a payment was received, or an invoice was issued for the supply).

As part of normal record-keeping requirements, Hotel Co will need to keep sufficient records to show which rule it applied for supplies (the normal timing rules or the optional rule).

Parties involved in supply can account for GST at different times

When more than two parties are involved in a supply of taxable accommodation made through an electronic marketplace (that is, when a listing intermediary is involved), there is no requirement for all parties to apply this optional rule consistently.

The effect of this is that a marketplace operator may choose to account for output tax according to their normal accounting basis, while a listing intermediary could, for example, deduct input tax for the flat-rate credit up to seven days after the completion of the performance of the services (or vice versa – the marketplace operator could account for output tax using the optional rule, and the listing intermediary could deduct input tax for the flat-rate credit according to their normal accounting basis).

Example 28: Listing intermediary involved chooses to use optional rule

Jared provides short-term rental accommodation in a property he owns through an electronic marketplace. Jared is not registered for GST and is therefore eligible for the flat-rate credit. He engages the services of Kylie, a listing intermediary, to manage his property and list it on the electronic marketplace for him.

Kylie is responsible for deducting input tax for the flat-rate credit for Jared. She is not responsible for returning output tax on any of the supplies made through the electronic marketplaces. Guests booking Jared's property always pay the marketplace operator directly, and Kylie receives payments from the marketplace operator a week before the guests check in to the property.

Kylie chooses to take an input tax deduction for the flat-rate credit based on the optional rule. Because the optional rule allows Kylie to deduct input tax for the flat-rate credit seven days after the performance of the services is completed or at an earlier time, she chooses to take the deduction in her GST return for the taxable period that includes the date that is a week before the check-in date (rather than a week after the check-out date). It does not matter whether the marketplace operator has chosen to apply the optional rule or the normal timing rules.

Input tax deductions for taxpayers using accommodation in their taxable activities

As outlined above, if a marketplace operator, listing intermediary, or host chooses to apply the optional accounting rule, this will not affect time of supply. This means a registered person purchasing taxable accommodation for use in their taxable activity is still entitled to deduct input tax on the supply at the normal time. This also means the usual rules for taxable supply information and supply correction information, including the timing of when this information must be provided to the recipient of the supply, still apply.

When a marketplace operator or a listing intermediary is responsible for providing taxable supply information to the recipient, the operator or listing intermediary must still provide it within 28 days of the time of supply, without the need for a request by the recipient. If the host is instead responsible for providing taxable supply information, they must provide it within 28 days of a request for it by the recipient.

Example 29: GST-registered business traveller using taxable accommodation made through electronic marketplace for taxable activity

Todd is travelling to Auckland for a business conference. Todd books accommodation for three nights through Stephen's Stays Ltd, the operator of an electronic marketplace, and pays a 10% deposit on the accommodation at the time of the booking. Todd is registered for GST and is using the accommodation for his taxable activity. He has elected to account for GST on the invoice basis.

Stephen's Stays Ltd chooses to use the optional rule by accounting for GST on the supply when the performance of the services is completed (at Todd's check-out date).

Stephen's Stays Ltd is still required to issue taxable supply information to Todd within 28 days of the time of supply, without the need for a request. Stephen's Stays Ltd emails a booking confirmation to Todd, which includes the taxable supply information. Todd takes a full input tax deduction for the accommodation in his GST return for the taxable period in which he paid the deposit.

Example 30: GST-registered business traveller shortens booking

Assume the same facts as in Example 29. A few months later, Todd decides to shorten his stay to two nights because the final day of the business conference is cancelled. Todd contacts Stephen's Stays Ltd to change his booking to two nights.

Stephen's Stays Ltd issues supply correction information to Todd, as per the existing rules. Todd then uses the supply correction information to return the excess input tax deducted (for the extra day of accommodation) as output tax in his next GST return.

Stephen's Stays Ltd has opted to use the optional rule (and has therefore not yet accounted for GST) so they do not need to adjust their GST position.

Transitional rule for taxable accommodation

Section 85E of the GST Act

A transitional issue with the GST rules for listed services may arise for operators of electronic marketplaces and listing intermediaries. The problem may arise when an operator of an electronic marketplace takes an accommodation booking before 1 April 2024 for a host who is not registered for GST. If time of supply occurs on or after 1 April 2024, the default position is that the marketplace operator or listing intermediary will have a GST liability for the supply, even though the price of the accommodation might not have been set with GST in mind.

To address this issue, a transitional rule in section 85E ensures listing intermediaries and operators of electronic marketplaces do not have to account for GST on contracts for taxable accommodation entered into before 1 April 2024, provided certain requirements are met.

Supplies covered by the transitional rule

The transitional rule applies when:

- the supply is of taxable accommodation
- the supply is made through an electronic marketplace
- the supply is made under a contract entered into before 1 April 2024
- the time of supply for that supply takes place on or after 1 April 2024
- an operator of an electronic marketplace or a listing intermediary would be treated by section 60C(2)(ab) as making the supply in the course or furtherance of its taxable activity in the absence of the transitional rule
- the person who would be treated as making the supply chooses that the transitional rule applies, and
- if the host is a registered person (or, as discussed below, in some cases if a listing intermediary is interposed between the host and the operator of the electronic marketplace), the person applying the transitional rule takes reasonable steps within a reasonable timeframe to notify the host or listing intermediary of their decision to apply the transitional rule, and to provide the host with sufficient information for them to correctly account for GST on the supply.

If the above conditions are met, section 85E(2) allows the marketplace operator or listing intermediary to treat the services as not having been supplied by them. The transitional rule would be applied by not including the relevant supplies in the "Total sales and income" box of the person's GST return, and by not deducting input tax for the flat-rate credit in respect of these supplies. The person does not need to notify Inland Revenue of their choice to apply the transitional rule, but they must keep evidence of their choice for a minimum period of seven years in accordance with the record keeping rules in the GST Act.

As outlined above, the transitional rule only applies if section 60C(2)(ab) would apply in its absence. Section 60C(2)(ab) provides that listed services are treated as supplied by the operator of the electronic marketplace through which the supply of services is made if those services are performed, provided or received in New Zealand.

In some instances, a listing intermediary (rather than the operator of the electronic marketplace) may be treated as making the supply of listed services. Provided certain conditions are met, section 60CB(7) provides that a listing intermediary is treated as the marketplace operator for the purposes of section 60C(2)(ab). This means the transitional rule can only ever be applied if the services would otherwise be treated as supplied in New Zealand by either an operator of an electronic marketplace or a listing intermediary. For instance, it would not be necessary to have the transitional rule apply to supplies by GST-registered hosts who have opted out of the application of the electronic marketplace rule in section 60C(2)(ab) using one of the available opt-out provisions.

Who can choose to apply transitional rule

Only the person who would be treated as the supplier of the services if section 60C(2)(ab) applied to the supply may choose to apply the transitional rule. In other words, the transitional rule can only ever be applied by an operator of an electronic marketplace or a listing intermediary, and only if that person would otherwise be treated as making the supply.

How transitional rule applies

When such a person chooses to apply the transitional rule, the choice they are making is that section 60C(2)(ab) does not apply to the supply. This means the rules for electronic marketplaces in section 60C (and, if applicable, the rules for listing intermediaries in section 60CB) do not apply to treat the services as supplied by the person. Instead, the host is the supplier for GST purposes.

This means that:

- A person applying the transitional rule will not account for and pay output tax on the relevant supply to Inland Revenue. All requirements related to the flat-rate credit (which only apply if section 60C(2)(ab) applies) also do not apply. This means the person applying the transitional rule should not deduct input tax for the flat-rate credit for the supply and pass this this on to the host.
- Any output tax liability on the supply remains with the host as per the pre-1 April 2024 rules. The host will only ever be liable to account for and pay output tax on the supply to Inland Revenue if they are a registered person making the supply in the course or furtherance of their taxable activity.

A decision by a marketplace operator or listing intermediary to apply the transitional rule does not change when the supply is deemed to occur. A GST-registered host who is required to account for GST on the supply because of the transitional rule should therefore account for the output tax in their GST return for the taxable period in which time of supply occurred (being the earlier of when a payment was received or an invoice was issued for the supply).

Notification requirements

In situations when the transitional rule is applied for a supply and the host is required to account for and pay GST on the supply to Inland Revenue, the host would need to know they are liable for GST on the supply.

A marketplace operator or listing intermediary who wishes to apply the transitional rule will in some situations only be entitled to do so on the condition they take reasonable steps to notify the host (or listing intermediary) of this decision. This notification must make it clear that the marketplace operator or listing intermediary is not liable for GST on the supply, and that this liability remains with the host. When this requirement applies, the notification must be made within a reasonable timeframe. The marketplace operator or listing intermediary should also take reasonable steps within a reasonable timeframe to ensure the host has sufficient information to correctly account for GST on the supply to Inland Revenue.

Meaning of "reasonable steps"

There are two scenarios in which notifying the host should be relatively straightforward:

- The first scenario is where an operator of an electronic marketplace would, in the absence of the transitional rule, be responsible for output tax on the supply, and there is no listing intermediary involved in the supply.
- The second scenario is where a listing intermediary would, in the absence of the transitional rule, be responsible for output tax on the supply. In other words, the listing intermediary and the operator of the electronic marketplace through which the supply is made have an agreement under section 60CB(6) that the listing intermediary is responsible for output tax on supplies of listed services.

In the above scenarios, the person applying the transitional rule must take reasonable steps to notify the host only if the host has told them they are GST-registered. As a result, some marketplace operators and listing intermediaries might only want to use the transitional rule for supplies where they are entitled to assume the host is not a registered person. This approach is acceptable because the transitional rule is intended to be flexible enough to allow marketplace operators and listing intermediaries to apply it for all bookings taken before 1 April 2024 when time of supply occurs on or after that date, or only a subset of those bookings.

The person applying the transitional rule must ensure the information they provide is sufficient for the host to correctly account for output tax on the relevant supplies. There is no requirement for any specific type of information to be provided, only that the information provided must simply be sufficient for this purpose. This is broad enough to include any information the marketplace operator or listing intermediary could share or provide that would enable the host to identify the relevant supplies, so that the host knows those supplies are the ones they need to account for in their GST return. For example, if the marketplace operator or listing intermediary will not be accounting for output tax on any of the host's bookings taken before 1 April 2024, then they could make sure (in addition to telling the host) they provide the host with the dates those bookings were made, or some other statement or notification that a specific booking was made before 1 April 2024.

There is a third possible scenario in which the host might need to be notified that the person is applying the transitional rule. This scenario arises when a booking is made before 1 April 2024 for accommodation that was listed on the electronic marketplace by a listing intermediary and, in the absence of the transitional rule:

- the operator of the electronic marketplace would be liable for output tax on the supply, not the listing intermediary, and
- the listing intermediary would be responsible for all requirements in respect of the supply that relate to the flat-rate credit, if applicable.

This scenario (when the marketplace operator is responsible for output tax and the listing intermediary is responsible for all the requirements related to the flat-rate credit) is the default setting under the rules in section 60CB applying to listing intermediaries. In this default scenario, the marketplace operator (if applying the transitional rule) must take reasonable steps to notify the listing intermediary that they are applying the transitional rule and to provide the listing intermediary with information that is sufficient for GST-registered hosts to correctly account for output tax on the supplies. The listing intermediary in this scenario should pass the relevant information on to GST-registered hosts within a reasonable timeframe.

The marketplace operator in this scenario must take reasonable steps to provide the information to the listing intermediary regardless of whether the host providing the accommodation is a registered person. This is for two reasons:

1. In this situation, the marketplace operator is unlikely to know anything about the host, including whether they are a registered person.
2. Even if the host is not a registered person, the listing intermediary still needs the same information from the marketplace operator that, if the host was GST-registered, would enable the host to identify the supplies for which it should account for GST to Inland Revenue. In this case, the information will enable the listing intermediary to correctly identify for which supplies it should not deduct input tax for the flat-rate credit. Therefore, the "reasonable steps" requirement to notify the listing intermediary serves a dual purpose.

Meaning of "reasonable timeframe"

A marketplace operator or listing intermediary choosing to apply the transitional rule must take reasonable steps to provide the necessary information to GST-registered hosts and/or to listing intermediaries within a reasonable timeframe. This means the marketplace operator or listing intermediary should make their best endeavours to ensure the information is provided as soon as practicable to allow a GST-registered host to account for output tax on the relevant supplies in the correct GST return, before that return is due to Inland Revenue. At the very latest, Inland Revenue would expect the necessary information to be provided in advance of the due date for the April 2024 GST returns (being 28 May 2024).

Example 31: Marketplace operator applies the transitional rule, host not registered person

In January 2024, Ben books accommodation at a Whangarei bach for several days in December 2024/January 2025 through Marketplace Co, an operator of an electronic marketplace. Will, the host providing the accommodation, is not registered for GST because his supplies are below the registration threshold.

The payment terms allow Ben the option of paying for the accommodation in instalments. Ben pays the first instalment in April 2024. No invoice has been issued, so this first payment means time of supply occurs in April 2024 when the new GST rules applying to listed services are in force.

Marketplace Co chooses to apply the transitional rule to this supply of accommodation, meaning that Marketplace Co would not account for GST on the supply. Marketplace Co applies the transitional rule by preparing and filing its GST return consistently with this position (that is, by not including the supply in the "Total sales and income" box in its GST return, and by not deducting input tax for the flat-rate credit). Because there is no listing intermediary involved in the supply and Will has not notified Marketplace Co that he is a registered person, Marketplace Co is not required to take reasonable steps to notify Will of the decision to apply the transitional rule.

Example 32: Reasonable steps requirement, no listing intermediary involved

In November 2023, Martin books accommodation at an Auckland bed and breakfast for one night in September 2024 through Marketplace Co. Graeme's Bed and Breakfast, the host providing the accommodation, is registered for GST but as of April 2024 has not opted out of the electronic marketplace rules.

The payment terms allow Martin to pay in full when he checks in at the bed and breakfast, which he will end up doing. As of April 2024, no invoice has been issued for the supply.

Marketplace Co intends to apply the transitional rule to all bookings made on its website before 1 April 2024 when time of supply will occur on or after 1 April 2024. This includes the booking made by Martin in November 2023.

In early April 2024, Marketplace Co provides communications to Graeme's Bed and Breakfast explaining that Marketplace Co will not be accounting for and paying GST on bookings taken before 1 April 2024 to Inland Revenue, and that GST on these bookings remains the legal responsibility of Graeme's Bed and Breakfast. The date on which Martin's booking was made is visible to Graeme's Bed and Breakfast via the Marketplace Co platform, so Graeme's Bed and Breakfast knows that it is required to include the supply in its GST return for the taxable period in which time of supply occurs (being when Martin pays upon checking in at the bed and breakfast if no invoice is issued before then).

Marketplace Co has taken reasonable steps within a reasonable timeframe to notify Graeme's Bed and Breakfast of the decision to apply the transitional rule and to ensure they have sufficient information to correctly account for GST on the supply. Marketplace Co is therefore entitled to apply the transitional rule for the supply.

Example 33: Marketplace operator takes reasonable steps to notify listing intermediary and host

Jacob, a non-GST registered owner of a bach in Timaru, uses a listing intermediary to deal with the day-to-day management of his bach and to list it for short-term rental on the Marketplace Co website. In March 2024, a booking for a stay occurring at the bach for three nights in July 2024 is received through the Marketplace Co platform. Payment for the booking is not made until April 2024 and no invoice is issued before that, so time of supply is deemed to occur in April 2024.

In early April 2024, Marketplace Co provides communications to the listing intermediary explaining that Marketplace Co will not be accounting for and paying GST on bookings taken before 1 April 2024 to Inland Revenue, and that GST on these bookings remains the legal responsibility of the accommodation hosts. In these communications, Marketplace Co advises the listing intermediary that this information will need to be passed on to GST-registered hosts so they can comply with their GST obligations. Marketplace Co also advises the listing intermediary that other relevant information that the GST-registered hosts will need to identify the bookings made before 1 April 2024 should be passed on to them, such as the dates the bookings were made (which is information that is accessible to the listing intermediary through the Marketplace Co platform).

Marketplace Co has taken reasonable steps within a reasonable timeframe to notify the listing intermediary of the decision to apply the transitional rule and to ensure the GST-registered hosts for accommodation listed on the platform by the listing intermediary have sufficient information to correctly account for GST on the supplies.

Because Jacob is not a registered person, the listing intermediary does not need to pass the information provided by Marketplace Co on to him. However, because Marketplace Co notified the listing intermediary that any GST liability for bookings taken before 1 April 2024 will remain with the hosts (instead of those supplies being subject to the new GST rules for listed services) and has provided sufficient information to the listing intermediary to enable these bookings to be identified, the listing intermediary knows it should not deduct input tax for the flat-rate credit on the supplies.

Consequential amendments

Sections 5(11G), 8C, 10(7D), 15(6), 19NB, 26AA, 51, 60, 60H, 75 and 77 of the GST Act

Several existing provisions affecting operators of electronic marketplaces have been amended to now refer to "listed services". These amendments are consequential in nature and reflect that the marketplace rules now apply to a new category of services supplied through electronic marketplaces.

GST registration

Section 51 of the GST Act

The rules for listed services require marketplace operators to register for, and return, GST on supplies of listed services that are performed, provided or received in New Zealand if the value of these supplies exceeds, or is expected to exceed, $60,000 in a 12-month period.

Non-resident marketplace operators can use a fair and reasonable method of converting foreign currency amounts to New Zealand dollars to determine whether they have exceeded the GST registration threshold. This is provided for in section 51.

Generally, the Commissioner is unable to allocate a tax file number (IRD number) to an offshore person, unless they have provided the Commissioner with evidence of their New Zealand bank account number. An exception to this requirement exists when the offshore person needs an IRD number solely because they are a non-resident supplier of goods or services under the GST Act. This exception applies to non-resident suppliers of listed services that would not need to provide evidence of a New Zealand bank account number if the only reason for obtaining a tax file number is so they can comply with their GST obligations.

Taxable supply information

Sections 8C(3)(a)(i) and 19NB of the GST Act

The general rules for taxable supply information require the person making a taxable supply to another registered person to provide the recipient with taxable supply information for the supply. This enables the recipient of the supply to deduct input tax. Under the general rules, taxable supply information may not need to be provided if the consideration for the supply is below a prescribed threshold.

Despite the general rules for taxable supply information, section 19NB provides that for listed services, taxable supply information (and, if applicable, supply correction information) must be provided to the recipient of the listed services in all circumstances without the need for a request, within 28 days of the time of supply. The purpose of this is to ensure that the recipient of listed services will receive sufficient information enabling them to deduct input tax, if applicable, for listed services they receive. It is also intended to reduce compliance costs for marketplace operators by removing the need for them to have bespoke systems for responding to requests for taxable supply information.

The rules for taxable supply information and supply correction information are explained on Inland Revenue's website (search keyword: taxable supply information).

Marketplace operators (and in some cases, listing intermediaries) are also treated as receiving supplies of listed services from underlying suppliers that operate through the electronic marketplace. No taxable supply information is required to be provided by underlying suppliers for these supplies under section 8C(3)(a)(i).

Taxable periods

Section 15(6) of the GST Act

Section 15 specifies the taxable periods for GST-registered persons.

The general rules for taxable periods are explained on Inland Revenue's website.

Section 15(6) provides that a non-resident marketplace operator that is treated as the supplier of listed services will have a quarterly taxable period based on a first quarter ending on 31 March. This means that a non-resident marketplace operator that supplies listed services will have the following taxable periods and due dates.

Table 1: Taxable periods for non-resident marketplace operators

Taxable period	GST payment and return due date
1 January to 31 March	7 May
1 April to 30 June	28 July
1 July to 30 September	28 October
1 October to 31 December	28 January of the following year

Marketplace operators that are tax resident in New Zealand will be subject to the ordinary rules for taxable periods.

Bad debt deductions

Section 26AA of the GST Act

Marketplace operators may collect GST on a supply of listed services it is treated as making in one of two ways:

- The marketplace operator arranges for the payment from the recipient of the services to be split when the payment is processed, with the amount of GST and the marketplace operator's facilitation fee or commission remitted to the operator, and the sale price (net of GST and the amount of the marketplace's fee or commission on the sale) remitted to the underlying supplier of the services.
- The recipient of the services may pay the underlying supplier directly, and the marketplace operator collects the GST along with its fee or commission from the underlying supplier.

In the second scenario, the marketplace operator may at times be unable to collect the GST from the underlying supplier. To prevent marketplace operators in this situation from being liable for GST that they are unable to collect, section 26AA will allow them to claim a bad debt deduction if:

- the underlying supplier fails to pass on the GST paid to them for the supply; and
- the operator of the marketplace has written off all amounts owed to it for the supply as a bad debt, including its fee or commission on the sale.

This rule will apply to a marketplace operator that is treated as the supplier of listed services if the underlying supplier is not an associated person under section 2A, and the marketplace operator:

- charges the underlying supplier a fee for making the supply through the marketplace
- accounts for GST on the supply and provides a return for the taxable period in which the supply was made
- has an agreement with the underlying supplier under which the underlying supplier is required to pay, from the consideration the underlying supplier receives from the recipient, an amount that includes the GST on the supply that the marketplace operator has accounted for, and
- the marketplace operator writes off as a bad debt the entire amount that the underlying supplier is required to pay (along with the entire amount of the marketplace's fee, if not already included in this amount).

Section 26AA(2) provides that the marketplace operator may deduct input tax equal to the amount of GST charged on the supply.

If the marketplace operator recovers an amount of the bad debt that was written off in an earlier taxable period, section 26AA(3) requires the marketplace operator to account for an amount of output tax that is a fraction of the amount of the input tax deduction taken earlier. This fraction is calculated by dividing the amount recovered by the total amount written off.

Record keeping

Section 75(3F) of the GST Act

GST-registered persons can apply to the Commissioner for authorisation to keep records at a place outside New Zealand or in a language other than English.

Section 75(3F) overrides this requirement for a non-resident supplier of listed services. This enables non-resident suppliers of listed services to keep records outside of New Zealand or store them in a language other than English without the need for approval from the Commissioner.

Use of foreign currency

Section 77(2) and (3) of the GST Act

Section 77(2) enables non-resident marketplace operators to account for GST on supplies of listed services they are treated as making in a foreign currency at the time of supply. This overrides the general rule that all amounts be expressed in New Zealand currency at the time of supply.

Section 77(3) provides that, when converting foreign currency amounts to New Zealand dollars for determining the amount of GST to be included in the GST return, the marketplace operator can use the foreign exchange rate applying at:

- the date of the supply
- the last day of the relevant taxable period
- the earlier of:
  - the date the marketplace operator files its return for the relevant taxable period, or
  - the due date for filing its return for the relevant taxable period, or
  - another date agreed between the marketplace operator and the Commissioner.

The marketplace operator may not change its currency conversion date for a period of 24 months unless they have agreed otherwise with the Commissioner. For example, it cannot choose to do the currency conversion using the exchange rate applying on the last day of the relevant taxable period if, in its GST return for the previous taxable period, it used the exchange rate applying on the date the return was filed.

New Zealand resident agents

Section 60(1A)(b) of the GST Act

A non-resident supplier of listed services may enter into an agency agreement with a New Zealand resident agent. If this applies, the agent (instead of the non-resident principal) is treated by section 60(1AB) as supplying listed services in the course and furtherance of the agent's taxable activity.

Vouchers

Section 5(11G)(a) of the GST Act

Generally, the issue or sale of a token, stamp or voucher with a face value is treated as a supply of goods and services by the issuer or seller. This applies unless the supplier of the token, stamp or voucher treats the supply as arising on the redemption of the token, stamp or voucher for goods and services. If the supplier of the token, stamp or voucher treats the supply as arising on redemption, the person who redeems the token, stamp or voucher for goods and services is treated as making the supply at the time of redemption, rather than at the time the voucher was issued or sold.

Section 5(11G)(a) has been amended to refer to "listed services" in addition to distantly taxable goods and remote services. This enables the seller of a face value voucher to treat GST as applying on the redemption of the voucher if the voucher is (or could be) redeemed for listed services. This is consistent with how the GST rules for vouchers apply to remote services and distantly taxable goods.

Example 34: Seller of voucher opts to use redemption basis

Charles buys a voucher with a face value of $100 from Smithy's Siestas Ltd, a popular electronic marketplace through which short-stay accommodation can be booked, as a gift for his daughter, Lucy. The voucher can be redeemed for short-stay accommodation bought through Smithy's Siestas Ltd.

Smithy's Siestas Ltd chooses to treat the supply for GST purposes as a rising on the redemption of the voucher (instead of the sale of the voucher). This means that GST will apply when Lucy redeems the voucher for listed services, and not on the sale or issue of the voucher itself.

Lucy uses the voucher as a credit towards short-stay accommodation she buys through Smithy's Siestas Ltd. Because Smithy's Siestas Ltd is treated as the supplier of the accommodation for GST purposes (rather than the underlying supplier of the accommodation), it is required to return GST equal to $13.04 (3/23 × $100) on the redemption of the voucher.

Discounts

Sections 10(7D) and 20(3N) of the GST Act

Section 10(7D) contains a special valuation rule to deal with the situation when a marketplace operator provides discounts for remote services, distantly taxable goods, or listed services that it is treated as supplying under the marketplace rules.

This special valuation rule provides that when a marketplace operator is deemed to make a supply to a recipient who accepts an offer of a discount funded by the operator, the supply is for the discounted price. This means that the amount of output tax that the marketplace operator is required to return on the supply is 3/23 of the total GST-inclusive amount paid by the recipient. However, the provision of the discount by the marketplace operator does not affect the calculation of the flat-rate credit for the underlying supplier, which is calculated as 8.5% of the GST-exclusive price the underlying supplier receives.

Example 35: Marketplace operator provides a discount for listed services provided by an underlying supplier

Kelvin is seeking accommodation for two nights for an upcoming trip in Kaikohe. He uses an electronic marketplace, Graeme's Getaways Ltd, to find a bed and breakfast that suits his needs for the weekend trip.

William owns a property in Kaikohe that is regularly booked through Graeme's Getaways Ltd. He sets the price as $250 per night plus GST. The GST-inclusive price is therefore $287.50 per night ($250 + $37.50 in GST).

Graeme's Getaways Ltd offers a discount of $10 per night on the accommodation, provided it is booked well in advance of the guest's arrival date. Kelvin accepts this offer, and so the final (GST-inclusive) price paid by Kelvin for the accommodation is $555. Graeme's Getaways Ltd pays for the discount, so William still receives the GST-exclusive consideration of $500.

Graeme's Getaways Ltd is required to calculate output tax on the price paid by Kelvin ($555). It returns output tax on the supply equal to $72.39 (3/23 × $555). However, the discount must be ignored when calculating the amount of the flat-rate credit for William. Graeme's Getaways Ltd deducts input tax for the flat-rate credit of $42.50 (8.5% × $500) and passes this amount on to William.

About this document

Special reports are published shortly after new legislation is enacted or Orders in Council are made to help affected taxpayers and their advisors understand the consequences of the changes.

Tax Administration (FamilyBoost Tax Credit—Extension of Dates to File Return of Income) Order 2024

Tax Administration (FamilyBoost Tax Credit—Extension of Dates to File Return of Income) Order 2025

SL 2024/240
SL 2025/8

Issued: 17 March 2025

These two Orders in Council, signed on 25 November 2024 and 24 February 2025 respectively, allowed FamilyBoost applicants filing late tax returns in previous years to access the FamilyBoost payment. People could apply for FamilyBoost once they had filed the tax return required for the quarter they are applying for.

Orders

The Tax Administration (FamilyBoost Tax Credit—Extension of Dates to File Return of Income) Order 2024 allows FamilyBoost applicants who filed tax returns late, up to 27 November 2024, to access the first FamilyBoost quarterly payment once they have filed the tax return required for the quarter.

The Tax Administration (FamilyBoost Tax Credit—Extension of Dates to File Return of Income) Order 2025 allows FamilyBoost applicants who filed tax returns late, up to 26 February 2025, to access both FamilyBoost quarterly payments, once they have filed the tax return required for the quarter they are applying for.

Both Orders extend the due date to file to 31 March 2025, solely for the purpose of the application of a FamilyBoost payment.

Background

The FamilyBoost tax credit provides a payment relating to 25% of a household's early childhood education costs up to a maximum cap each quarter. The maximum FamilyBoost tax credit that can be claimed is reduced once quarterly household income exceeds $35,000 (equivalent to $140,000 a year). This requires Inland Revenue to determine a household's income from their tax returns and end of tax year assessments, and for people to file those returns when required. As such, FamilyBoost would not be available if a person or their partner failed to file a tax return when required.

Currently, the FamilyBoost legislation overreaches, requiring applicants to not only have filed their most recent tax return, but to have filed it on time. Consequently, those who have filed their tax return but did so late for one or both of the last two years are unable to apply for a FamilyBoost tax credit. This is despite providing the income information Inland Revenue needs to calculate their payment. The same situation applies to the person's partner. This is not the intended outcome. Inland Revenue estimates that approximately 980 families may be impacted by this issue per year.

The intended outcome is to allow those who have filed the tax return that is required for the quarter they are applying for to access FamilyBoost. This is regardless of whether this tax return was supplied on time or late. The key requirement is to have the household's income information to determine if the person can claim the maximum payment or a lesser amount.

To align the FamilyBoost legislation with this intent, a remedial amendment will be made in the Taxation (Annual Rates for 2024–25, Emergency Response, and Remedial Measures) Bill, to be enacted this year. FamilyBoost applications would then only be disallowed when a required return of tax remains outstanding.

In the meantime, the two Orders have been approved to allow households to apply for FamilyBoost when they have not filed their tax returns by the due dates, by extending the time required to file for the purposes of FamilyBoost applications.

Key features

To allow access to FamilyBoost in the interim for parents who have filed late in the last two tax years, two Orders in Council are required using section 226 of the Tax Administration Act 1994.

These Orders provides a future date, 31 March 2025, for people to file the tax return, for the purpose of applying for FamilyBoost. This has the effect that households are no longer late filers as far as section MH 3(4) of the Income Tax Act 2007 (the FamilyBoost requirements) is concerned, when they file tax returns by 31 March 2025.

The Orders cover periods up to the date of each Order: the 2024 Order covers people who filed late up to 27 November 2024. The 2025 Order covers people who filed late up to 26 February 2025. At the time of publishing, Orders in Council issued under section 226 can only be provided for people who are already late filers at the time the Order is approved.

In practical terms, the Orders apply to:

- returns of income for the 2023–24 tax year that were filed late
- returns of income for the 2022–23 tax year that were filed late (if the person's 2023–24 return has not been filed and is not late for filing).

Effective date

The 2024 Order in Council was signed on 25 November 2024 and takes effect from 27 November 2024.

The 2025 Order in Council was signed on 24 February 2025 and takes effect from 26 February 2025.

Further information

The new Orders in Council can be found at:

Tax Administration (FamilyBoost Tax Credit—Extension of Dates to File Return of Income) Order 2024 (SL 2024/240) – New Zealand Legislation

Tax Administration (FamilyBoost Tax Credit—Extension of Dates to File Return of Income) Order 2025 (SL 2025/8) Contents – New Zealand Legislation

Tax Administration (Reportable Jurisdictions for Application of CRS Standard) Amendment Regulations 2025

SL 2025/15

Issued: 17 March 2025

This Order in Council adds Armenia, Jordan, Rwanda, Senegal, and Tunisia to New Zealand's existing list of 106 reportable jurisdictions under the Common Reporting Standard.

Order

The Tax Administration (Reportable Jurisdictions for Application of CRS Standard) Amendment Regulations 2025 was made on 24 February 2025 and comes into force on 31 March 2025. It updates New Zealand's existing list of 106 reportable jurisdictions by adding Armenia, Jordan, Rwanda, Senegal, and Tunisia.

Background

Reportable jurisdictions are relevant to the Common Reporting Standard (CRS), which was enacted in New Zealand in 2017 as part of New Zealand's implementation of the G20/OECD Standard for Automatic Exchange of Financial Account Information in Tax Matters (AEOI). Reportable jurisdictions are territories to which Inland Revenue will provide certain information on their residents that is reported to Inland Revenue by financial institutions, in accordance with the CRS rules.

Pursuant to section 226D of the Tax Administration Act 1994 (the Act), additions and deletions to the list of reportable jurisdictions must be made by Order in Council.

Effective date

Armenia, Jordan, Rwanda, Senegal, and Tunisia will be reportable jurisdictions for reporting periods beginning on or after 1 April 2024.

Further information

A full list of reportable jurisdictions can be found on the Inland Revenue website and the Order in Council can be found at:

https://www.legislation.govt.nz/regulation/public/2025/0015/latest/LMS1023364.html

LEGISLATION AND DETERMINATIONS

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

AE 25/01: Participating jurisdictions for the CRS applied standard

Issued: 19 March 2025

EFFECTIVE: 1 April 2025

Determination

New Zealand's list of participating jurisdictions made by determination under section 91AAU of the Tax Administration Act 1994 for the purposes of the CRS applied standard and associated requirements under Part 11B of the Tax Administration Act 1994 has been amended with effect from the 1st of April 2025 as follows:

Jurisdictions added to the participating jurisdictions list

Armenia	Jordan	Rwanda	Senegal
Tunisia			

Full list of participating jurisdictions from 1 April 2025

Albania	Andorra	Anguilla	Antigua and Barbuda
Argentina	Armenia	Aruba	Australia
Austria	Azerbaijan	Bahamas	Bahrain
Barbados	Belgium	Belize	Bermuda
Brazil	British Virgin Islands	Brunei	Bulgaria
Canada	Cayman Islands	Chile	China
Colombia	Cook Islands	Costa Rica	Croatia
Curaçao	Cyprus	Czech Republic	Denmark
Dominica	Ecuador	Estonia	Faroe Islands
Finland	France	Georgia	Germany
Ghana	Gibraltar	Greece	Greenland
Grenada	Guernsey	Hong Kong	Hungary
Iceland	India	Indonesia	Ireland

Isle of Man	Israel	Italy	Japan
Jamaica	Jersey	Jordan	Kazakhstan
Kenya	Korea	Kuwait	Latvia
Lebanon	Liechtenstein	Lithuania	Luxembourg
Macao	Malaysia	Maldives	Malta
Marshall Islands	Mauritius	Mexico	Moldova
Monaco	Montenegro	Montserrat	Morocco
Nauru	Netherlands	New Caledonia	New Zealand
Nigeria	Niue	Norway	Oman
Pakistan	Panama	Peru	Poland
Portugal	Qatar	Romania	Russia
Rwanda	Saint Kitts and Nevis	Saint Lucia	Saint Vincent and the Grenadines
Samoa	San Marino	Saudi Arabia	Senegal
Seychelles	Singapore	Sint Maarten	Slovak Republic
Slovenia	South Africa	Spain	Sweden
Switzerland	Thailand	Tunisia	Turkey
Turks and Caicos Islands	United Arab Emirates	United Kingdom	Uganda
Ukraine	Uruguay	Vanuatu	

Signed by John Nash on the 19th day of March 2025

John Nash

Strategic Advisor, International Revenue Strategy

Inland Revenue

References

Legislative references

Tax Administration Act 1994: s 91AAU

DET 25/01: GST on supplies through electronic marketplaces – hostel and motel opt-out agreement criteria

Application

This determination sets criteria for when a person who supplies accommodation through an electronic marketplace (an underlying supplier) can enter into an opt-out agreement with the operator of an electronic marketplace. The determination is made under section 60C(2BC) of the Goods and Services Tax Act 1985.

The determination applies to hostels and motels that were registered for GST on or before 1 April 2024 and exceed the GST registration threshold (making supplies of more than $60,000 for the last 12-months or expecting to make supplies of more than $60,000 for the next 12-months), where they make supplies both through an electronic marketplace and directly to recipients of accommodation services. It applies for hostels and motels that would otherwise be unable to opt-out of the electronic marketplace rules as they do not satisfy the statutory opt-out thresholds (i.e., because they make taxable supplies of $500,000 or less in a 12-month period and do not have 2,000 nights of accommodation listed as available on one electronic marketplace for a 12-month period).

The determination applies for taxable periods starting on or after 1 April 2025 and ending on or before 31 March 2028.

REPLACES

- **DET 24/02**: GST on accommodation supplied through electronic marketplaces – opt-out agreement criteria

Determination

Pursuant to section 60C(2BC) of the Goods and Services Tax Act 1985 (the Act), the Commissioner of Inland Revenue has determined that a person who is an underlying supplier may enter into an opt-out agreement with an operator of an electronic marketplace, if:

(a) they were registered under the Act on or before 1 April 2024 and their registration has not subsequently been cancelled under section 52 of the Act; and

(b) they are required to be registered as a result of section 51(1) of the Act; and

(c) they do not meet the requirements of section 60C(2BE) or section 60C(2BF) of the Act; and

(d) they supply accommodation services referred to in section 8C(2)(a) of the Act in a hostel or motel; and

(e) the accommodation includes both:

   (i) accommodation that is listed as available on 1 or more electronic marketplace; and

   (ii) accommodation that can be booked directly with the underlying supplier.

Interpretation

In this determination words and expressions have the same meaning as in the Goods and Services Tax Act 1985.

This determination was signed by me on 14 March 2025.

Stephen Donaldson

Technical Lead, Technical Standards, Legal Services

Inland Revenue

Commentary on DET 25/01

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

All section references are to the Goods and Services Tax Act 1985 (the Act).

Background

The Act includes rules relating to the application of goods and services tax (GST) to listed services supplied through an electronic marketplace (the marketplace rules) which apply from 1 April 2024. Listed services include the supply of taxable accommodation services in New Zealand (section 8C(2)(a)). Taxable accommodation services include short-term rentals and visitor accommodation that is not an exempt supply under section 14(1)(c).

Under the marketplace rules, when taxable accommodation services are supplied through an electronic marketplace by a person (an underlying supplier) to another person (the recipient of the services), the operator of the electronic marketplace is usually treated as making the supply to the recipient of the services and will be responsible for collecting and returning GST on these supplies. This means the underlying supplier will not be responsible for collecting and returning GST and will instead include sales they make through the electronic marketplace in their GST returns as zero-rated supplies.

For more information on the marketplace rules, see **GST on accommodation and transportation services supplied through online marketplaces**.

Ability to opt-out of the marketplace rules

In certain circumstances, underlying suppliers can opt-out of the marketplace rules, which means they will remain responsible for their own GST obligations. Underlying suppliers that opt-out of the marketplace rules would include supplies of listed services made through an electronic marketplace in their GST returns as standard-rated supplies.

Under the Act an underlying supplier can choose to opt-out of the marketplace rules where:

- The underlying supplier (or a group of companies they are part of) has 2,000 nights of accommodation available on one electronic marketplace in a 12-month period or a reasonable expectation they can meet this threshold for any 12-month period (section 60C(2BE)). An underlying supplier that meets this criterion and wants to opt-out must enter into an opt-out agreement with the operator of the electronic marketplace to opt-out of the marketplace rules.
- The underlying supplier is required to maintain a monthly or two-monthly taxable period (i.e., they make taxable supplies of more than $500,000 in a 12-month period) and is not a natural person (section 60C(2BF)). To opt-out of the marketplace rules, an underlying supplier that meets this criterion must notify the operator of the electronic marketplace that they will continue to remain responsible for their own GST obligations.

The Commissioner of Inland Revenue (the Commissioner) also has the power, under section 60C(2BC), to make a determination setting out circumstances and criteria a person must meet to enter into an opt-out agreement. That is, the Commissioner can make a determination that would enable certain underlying suppliers that do not meet the statutory thresholds in section 60C(2BE) or section 60C(2BF) to opt-out of the marketplace rules.

In making a determination under section 60C(2BC), the Commissioner must have regard to the following factors set out in section 60C(2BD):

- the compliance costs that would arise for underlying suppliers in making changes to their accounting systems and practices; and
- the size, scale, and nature of the services and activities undertaken by underlying suppliers.

DET 25/01

The determination enables a person that is an underlying supplier to enter into an opt-out agreement with an operator of an electronic marketplace if:

- they were registered for GST on or before 1 April 2024 and their registration has not subsequently been cancelled;
- they exceed the $60,000 GST registration threshold in section 51(1) (i.e., they are required to be registered for GST because they made supplies of more than $60,000 for the last 12-months, or they expect to make supplies of more than $60,000 for the next 12-months);
- they do not satisfy the statutory opt-out thresholds in section 60C(2BE) or section 60C(2BF) (i.e., they do not meet the 2,000 nights or $500,000 of taxable supplies thresholds);
- they supply taxable accommodation services in a hostel or a motel ("hostel" and "motel" are not defined in the Act so have their ordinary meanings); and
- the accommodation includes both accommodation that can be booked through an electronic marketplace and accommodation that can be booked directly with the underlying supplier (this means an underlying supplier that only makes supplies through an electronic marketplace will not be eligible to enter into an opt-out agreement in reliance on the determination).

In addition to satisfying the criteria in the determination set out above, for an underlying supplier to be able to opt-out of the marketplace rules and remain responsible for their own GST obligations they must also meet other requirements in section 60C(2BB). These requirements are:

- The documentation provided to the recipient of the services identifies the supply as being made by the underlying supplier and not the operator of the electronic marketplace (section 60C(2BB)(b)).
- The underlying supplier and the operator of the electronic marketplace have agreed, recording their agreement in a document, that the underlying supplier is liable for the payment of GST in relation to the supplies made through the electronic marketplace, and will continue to remain responsible for their tax obligations under the Act (section 60C(2BB)(c)). This includes providing the recipient of the services with taxable supply information, if required, and providing GST returns and paying GST to Inland Revenue.

If an underlying supplier stops meeting the criteria in DET 25/01

If an underlying supplier stops meeting the criteria set out in this determination the Commissioner expects the underlying supplier to withdraw their agreement with the electronic marketplace operator.

Relevant factors when making a determination

In making the determination the Commissioner has had regard to the factors in section 60C(2BD).

The Commissioner considers that, compared to other providers of taxable accommodation that are unable to opt-out of the marketplace rules, the size, scale, and nature of the services and activities undertaken by hostels and motels that satisfy the determination criteria have a sufficient degree of commerciality for it to be appropriate for them to continue to be responsible for their own GST obligations.

The Commissioner also recognises that many hostels and motels will meet the statutory thresholds for opting out of the marketplace rules in section 60C(2BE) or section 60C(2BF).

The determination enables those hostels and motels who do not meet the statutory thresholds (for example, because they close during certain seasons of the year) to continue with existing accounting systems and practices they had in place before the introduction of the marketplace rules on 1 April 2024 until 31 March 2028.

The Commissioner accepts that in their current situation, if they were unable to opt-out of the marketplace rules, underlying suppliers described in the determination would face increased compliance costs associated with making changes to their existing accounting systems and practices. Improvements to accounting systems and practices may reduce the impact of compliance costs in future years. The Commissioner will consider this factor when reviewing the determination.

Application

The determination has been issued for a three-year period (for taxable periods starting on or after 1 April 2025 and ending on or before 31 March 2028) and will be reviewed before its expiry.

FDR 2025/03: Determination the fair dividend rate may not be used to calculate FIF income by investors in Institutional Cash Series plc: BlackRock ICS US Dollar Liquidity Fund – Premier (Dis) Shares

Reference

This determination is made under section 91AAO(1)(b) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Technical Specialist under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Premier (Dis) Shares in the BlackRock ICS US Dollar Liquidity Fund (the Fund) of Institutional Cash Series plc to which this determination applies, are an attributing interest in a foreign investment fund (FIF) for New Zealand resident investors.

New Zealand resident investors are required to apply the FIF rules to determine their tax liability in respect of their investment in units in the Fund each year.

The Fund invests in a broad range of transferable securities such as securities, instruments and obligations that may be available in the relevant markets (both within and outside the US) for instruments denominated in US Dollars including securities, instruments and obligations issued or guaranteed by the US Government or other sovereign governments or their agencies and securities, instruments and obligations issued or guaranteed by supranational or public international bodies, banks, corporate or other commercial issuers.

For New Zealand resident investors, Premier (Dis) shares in the Fund do not represent an attributing FIF interest that comprises of non-ordinary shares as described in section EX 46(10)(a) -(db) of the Income Tax Act 2007. Consequently, investors would not be prevented from using the FDR method pursuant to section EX 46(8)(a) of the Income Tax Act 2007 in the absence of a determination under section 91AAO of the Tax Administration Act 1994.

However, due to the nature of the overall arrangement it is considered that the application of the FDR method would impose unnecessarily high compliance costs on New Zealand investors, as it would require performing a substantial number of quick sale adjustment calculations and associated foreign exchange calculations every time that the investor withdraws funds from the Fund during the year.

Scope of determination

This determination is issued on the basis of information provided to the Commissioner before the date of this determination and applies to an attributing interest in a FIF held by New Zealand resident investors in a non-resident issuer where:

- This non-resident issuer:
    - Is an Irish public limited company that issues multiple classes of shares; and
    - Is known at the date of this determination as Institutional Cash Series plc; and
    - Is structured as an umbrella fund with segregated liability between sub-funds; and
    - Is managed by BlackRock Asset Management Ireland Limited, a company incorporated in Ireland;
- The attributing interest consists of a US dollar denominated class of shares, Premier (Dis) Shares, issued by that non-resident that provide exposure solely to the Fund.
- The Fund:
    - Holds assets that predominantly (80% or more by value at a time in the income year) comprise high-quality short-term money market instruments, which are either USD denominated financial arrangements that are debt securities or instruments that are economically equivalent to USD debt.
    - Has not entered into any arrangements which provide an overall economic return as if the securities were denominated in New Zealand dollars
    - May make distributions of income (if any) to the shareholders in the form of cash or additional shares but does not guarantee that any income will be derived or that a distribution will be made

Interpretation

In this determination, unless the context otherwise requires

"Fair dividend rate method" means the fair dividend rate method under section YA 1 of the Income Tax Act 2007;

"Financial arrangement" means financial arrangement under section EW 3 of the Income Tax Act 2007;

"Foreign investment fund" means foreign investment fund under section YA 1 of the Income Tax Act 2007;

"Non-resident" means a person that is not resident in New Zealand for the purposes of the Income Tax Act 2007;

"The Fund" means the BlackRock ICS US Dollar Liquidity Fund, a sub-fund of Institutional Cash Series Plc.

Determination

An attributing interest in a FIF to which this determination applies is a type of attributing interest for which a person may not use the FDR method to calculate FIF income from the interest.

Application Date

This determination applies for the 2025 income year and subsequent income years.

Under section 91AAO(3B) of the Tax Administration Act 1994, this determination does not apply for a person and an income year beginning before the date of determination unless the person chooses that the determination applies for the income year.

Dated on this 26 day of March 2025

Iain McConville

Technical Specialist

FDR 2025/04: Determination the fair dividend rate method may not be used to calculate FIF income by investors in Institutional Cash Series plc: BlackRock ICS US Treasury Fund – Premier (Dis) Shares

Reference

This determination is made under section 91AAO(1)(b) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Technical Specialist under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Premier (Dis) Shares in the BlackRock ICS US Treasury Fund (the Fund) of Institutional Cash Series plc to which this determination applies, are an attributing interest in a foreign investment fund (FIF) for New Zealand resident investors.

New Zealand resident investors are required to apply the FIF rules to determine their tax liability in respect of their investment in units in the Fund each year.

The Fund invests in a broad range of transferable securities such as securities, instruments and obligations that may be available in the relevant markets (both within and outside the US) for instruments denominated in US Dollars including securities, instruments and obligations issued or guaranteed by the US Government or other sovereign governments or their agencies and securities, instruments and obligations issued or guaranteed by supranational or public international bodies, banks, corporate or other commercial issuers.

For New Zealand resident investors, Premier (Dis) shares in the Fund do not represent an attributing FIF interest that comprises of non-ordinary shares as described in section EX 46(10)(a) -(db) of the Income Tax Act 2007. Consequently, investors would not be prevented from using the FDR method pursuant to section EX 46(8)(a) of the Income Tax Act 2007 in the absence of a determination under section 91AAO of the Tax Administration Act 1994.

However, due to the nature of the overall arrangement it is considered that the application of the FDR method would impose unnecessarily high compliance costs on New Zealand investors, as it would require performing a substantial number of quick sale adjustment calculations and associated foreign exchange calculations every time that the investor withdraws funds from the Fund during the year.

Scope of determination

This determination is issued on the basis of information provided to the Commissioner before the date of this determination and applies to an attributing interest in a FIF held by New Zealand resident investors in a non-resident issuer where:

- This non-resident issuer:
  - Is an Irish public limited company that issues multiple classes of shares; and
  - Is known at the date of this determination as Institutional Cash Series plc; and
  - Is structured as an umbrella fund with segregated liability between sub-funds; and
  - Is managed by BlackRock Asset Management Ireland Limited, a company incorporated in Ireland.
- The attributing interest consists of a US dollar denominated class of shares, Premier (Dis) Shares, issued by that non-resident that provide exposure solely to the Fund.
- The Fund:
  - Holds assets that predominantly (80% or more by value at a time in the income year) comprise high-quality short-term money market instruments, which are either USD denominated financial arrangements that are debt securities or instruments that are economically equivalent to USD debt.
  - Has not entered into any arrangements which provide an overall economic return as if the securities were denominated in New Zealand dollars.
  - May make distributions of income (if any) to the shareholders in the form of cash or additional shares but does not guarantee that any income will be derived or that a distribution will be made.

LEGISLATION AND DETERMINATIONS

Interpretation

In this determination, unless the context otherwise requires

"Fair dividend rate method" means the fair dividend rate method under section YA 1 of the Income Tax Act 2007;

"Financial arrangement" means financial arrangement under section EW 3 of the Income Tax Act 2007;

"Foreign investment fund" means foreign investment fund under section YA 1 of the Income Tax Act 2007;

"Non-resident" means a person that is not resident in New Zealand for the purposes of the Income Tax Act 2007;

"The Fund" means the BlackRock ICS US Treasury Fund, a sub-fund of Institutional Cash Series plc.

Determination

An attributing interest in a FIF to which this determination applies is a type of attributing interest for which a person may not use the FDR method to calculate FIF income from the interest.

Application Date

This determination applies for the 2025 income year and subsequent income years.

Under section 91AAO(3B) of the Tax Administration Act 1994, this determination does not apply for a person and an income year beginning before the date of determination unless the person chooses that the determination applies for the income year.

Dated on this 26 day of March 2025

Iain McConville

Technical Specialist

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**

Product Ruling - BR Prd 25/01

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of person who applied for the Ruling | Ingoa o te tangata i tono i te Whakatau

This Ruling has been applied for by Taxi Limited.

Taxation Laws | Ture Tāke

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

This Ruling applies in respect of ss OB 6, OB 35, OP 9 and OP 33.

The Arrangement to which this Ruling applies | Te Whakaritenga i pāngia e tēnei Whakataunga

This Arrangement is the lending of amounts (Advances) by Taxi Limited (Taxi) to its clients (Clients) secured by the client transferring by way of security their entitlement to amounts (Tax Credits) deposited in the tax pooling account operated by Tax Traders Limited (Tax Pooling Account).

Further details of the Arrangement are set out in the paragraphs below.

Parties to the Arrangement

1. The parties to the Arrangement are:
   a) Taxi;
   b) each Client;
   c) Tax Traders Limited as tax pooling intermediary; and
   d) Public Trust as custodial trustee of the Tax Pooling Account.

Documents relevant to the Arrangement

2. The Taxi Terms and Conditions (Terms) document provided to Inland Revenue on 20 March 2025 describes the Arrangement.
3. The final executed documentation will not be materially different from the Terms provided to Inland Revenue on 20 March 2025.

Terms of Advances

4. Taxi makes Advances to Clients, and Clients agree to pay interest at an agreed rate on the Advances, to pay facility fees, and to pay certain other amounts (such as enforcement costs).
5. As security for each Advance, the facility fees, the Client's interest payment obligations and the Client's other payment obligations under the Terms, the Client agrees to transfer Tax Credits to Taxi by way of security.
6. Tax Credit is defined as meaning a direct or indirect payment of a provisional tax instalment by the Client into the Tax Pooling Account in respect of the preceding 12-month period or (if the parties agree) an earlier period. Only Tax Credits held through the Tax Pooling Account can be used as security under the Arrangement.

7. The Tax Pooling Account is the trust account into which Tax Traders Limited pays an amount that they receive from a person in their role as an intermediary as defined in the Income Tax Act 2007. Tax Traders Limited has appointed Public Trust as an independent trustee to hold, maintain and operate the Tax Pooling Account on behalf of its clients and other persons who deposit money into the Tax Pooling Account at the request of Tax Traders Limited.
8. If an Advance is not repaid or prepaid in full by its due date, any facility fee is not paid when due or any interest or other amount payable under the Terms is not paid when due, the Client irrevocably authorises Taxi to retain, apply, sell or otherwise dispose of the Tax Credits.
9. All costs of sale will be for the account of the Client. Any residual amount after all Advances, fees, interest, enforcement and other amounts have been paid or repaid in full to Taxi, will be paid by Taxi into the Client's bank account within two business days. Any Tax Credits not retained, applied, sold or otherwise disposed of will, after the repayment of Taxi in full in accordance with the preceding sentence, be available for re-transfer to the Client.
10. The Client may request that Tax Credits transferred are (subject to Taxi's enforcement rights) re-transferred to it on a dollar-for-dollar basis as Advances are repaid or prepaid.
11. When all Advances, fees, interest, enforcement and other amounts have been paid or repaid in full, the Client may request that Taxi re-transfer any remaining Tax Credits held by Taxi to the Client.
12. A re-transfer of a Tax Credit on repayment or prepayment of an Advance involves a transfer of the relevant amount of a Tax Credit with the same "date stamp" as that which applied to the original deposit made by the Client.

How the Taxation Laws apply to the Arrangement | Ko te pānga o ngā Ture Tāke ki te Whakaritenga

The Taxation Laws apply to the Arrangement as follows:

(a) The transfer by way of security of Tax Credits from a Client to Taxi under the Terms will not result in:
   (i) the Client (or the relevant nominated company if the Client is a member of a consolidated imputation group) being required to debit its ICA under ss OB 35 or OP 33; or
   (ii) Taxi (or the relevant nominated company if Taxi is a member of a consolidated imputation group) having a credit to its ICA under ss OB 6 or OP 9.

Period or income year for which this Ruling applies | Te wā, te tau moni whiwhi rānei i pāngia ai e tēnei Whakataunga

This Ruling will apply for the period beginning on 1 April 2025 and ending on 31 March 2028.

This Ruling is signed by me on the 31st day of March 2025.

Howard Davis

Group Leader | Rōia Kaihautū ā-ropu Taake

Tax Counsel Office | Te Tari Tohutohu Tāke

Product Ruling – BR Prd 25/02

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of person who applied for the Ruling | Ingoa o te tangata i tono i te Whakatau

This Ruling has been applied for by Electric Bikes NZ Limited (trading as The Wheel Deal).

Taxation Laws | Ture Tāke

This Ruling applies in respect of ss BG 1, CX 2, CX 19D, and RD 3 of the Income Tax Act 2007 (ITA) and ss 3A(1), 8(1), 10(2), 20(3), 20(3C) and 76 of the Goods and Services Tax Act 1985 (GSTA).

The Arrangement to which this Ruling applies | Te Whakaritenga i pāngia e tēnei Whakataunga

The Arrangement is The Wheel Deal's provision of self-powered or low-powered commuting vehicles (Equipment) to the Employees of The Wheel Deal's customers (Employers), where the Employees agree to a temporary reduction in salary in return for the provision of the Equipment. The Equipment can be a bicycle, electric bicycle, scooter or electric scooter.

Further details of the Arrangement are set out in the paragraphs below.

Parties to the Arrangement and overview of the Arrangement steps

1. The parties to the Arrangement are as follows:
   a) The Wheel Deal is a New Zealand resident company that facilitates the provision of the Equipment to the Employee.
   b) The Employer is a New Zealand resident employer who has contracted with The Wheel Deal under a Scheme Participation Agreement (Employer Contract).
   c) The Employee is a New Zealand resident employee of the Employer.
   d) The Dealer is a third-party retail supplier or store that has entered into a Scheme Participation Agreement (Dealer Contract) with The Wheel Deal.
2. The Arrangement steps are as follows:
   a) The Employer and Dealer each enter into a Scheme Participation Agreement with The Wheel Deal respectively.
   b) The Wheel Deal works with the Employer to promote the scheme to Employees.
   c) The Employee who has entered into a Salary Sacrifice Agreement with their Employer places a product order with the Dealer. The Dealer supplies The Wheel Deal with the order details through a portal, which the Employer then authorises. The Wheel Deal invoices the Employer for the Equipment.
   d) Ownership of the Equipment is transferred to the Employee once the Employer has paid for it in full and the Dealer has supplied it.
   e) The Employer pays The Wheel Deal for the Equipment. The Wheel Deal passes the payment (net of fee) to the Dealer within 1 working day after the Equipment has been collected by the Employee.
   f) The Dealer pays a fee to The Wheel Deal for each item of Equipment sold.

Employee benefit scheme

3. The Employer enters into the Scheme Participation Agreement (Employer Contract) with The Wheel Deal for the purpose of offering Employees the ability to enter into a salary sacrifice to obtain the Equipment as a benefit.
4. The Wheel Deal supplies the Employer with the necessary intellectual property and documentation for the Employer to provide and help facilitate Equipment being supplied to Employees through one or more local stores.
5. Employees who agree to enter into a Salary Sacrifice Agreement with their Employer choose which Equipment is to be purchased from a Dealer. The Dealer enters this order into a Portal. After the Employer authorises the order, The Wheel Deal then arranges to purchase the Equipment at market value from the Dealer.

6. The Wheel Deal invoices the Employer for an amount that is no more than the cost of the Equipment to the Wheel Deal (ie, the market value of the Equipment). The scheme includes a free 6-month service package with the Dealer.
7. Once the Employer has paid for the Equipment in full, the Employee will take possession of the Equipment.
8. To participate in the scheme the Employer and Employee must agree to reduce the Employee's annualised gross salary or wages for a period of 12 months under a Salary Sacrifice Agreement.
9. The Employer Bike Purchase Scheme Policy (Scheme Policy) sets out the following conditions:
   a) The Employer Bike Purchase Scheme (the Scheme) can only be used to obtain a bike, e-bike, scooter or e-scooter that the Employee will use mainly for commuting to and from work.
   b) The Scheme will comply with any regulations issued under s CX 19D(3) of the ITA.
   c) The Scheme does not apply to the purchase of any accessories such as helmets, locks or lights.
   d) With the exception of extraordinary circumstances (eg, theft or destruction) Employees are only entitled to use the Scheme once every 5 years in relation to bikes and e-bikes and once every 4 years in relation to scooters and e-scooters.
   e) Employees cannot be reimbursed for Equipment they have purchased themselves.
10. The Salary Sacrifice Agreement forms part of the Employee's employment agreement and is entered into before the Employer provides the Equipment. The terms and conditions in the Scheme Policy form part of the Salary Sacrifice Agreement. Under the Salary Sacrifice Agreement, the following conditions apply:
    a) The Employer and Employee agree on the amount of the reduction in the Employee's annualised gross salary and wages over a 12-month period, which will not exceed the cost of the Equipment to the Wheel Deal (ie, the market value of the Equipment). Employees cannot have the cost of the Equipment taken from a single pay or bonus payment.
    b) The Employee acknowledges that the reduction in salary or wages may affect their KiwiSaver contributions, student loan deductions and other employment benefits, as well as entitlements under the Holidays Act 2003.
    c) The salary sacrifice will be renegotiated or suspended if the Employee's salary or wages fall below the minimum wage.
    d) The salary sacrifice will be suspended if the Employee is absent from work for an agreed period, such as for unpaid parental leave or a career break.
    e) The Employee agrees that they will use the Equipment mainly for commuting to and from work.
    f) The Employee acknowledges that they will not be entitled to any refund of the amount sacrificed under the Salary Sacrifice Agreement for any reason. They also agree that they will not make any claims against the Employer about the Equipment including but not limited to the quality or performance of the Equipment.
    g) The Employee acknowledges that full ownership of the Equipment will pass to them when they receive it and they will be responsible for any insurance and ongoing maintenance.
11. Employees who have obtained Equipment under the Scheme will be bonded to the Employer for 1 year from the date that the Employer purchases the Equipment (the bond period). If the Employee leaves the employment of the Employer within the bond period, they will have to pay the bond amount to the Employer on a pro rata basis. The bond amount can be taken from their final pay. If their final pay does not clear the bond amount, they will pay the remaining amount to the Employer's bank account before their employment ceases. The bond amount is the cost to the Employer of providing the Equipment to the Employee. If the Employee takes a career break, unpaid leave or unpaid parental leave during the bond period, the bond period will restart when they return from their break or leave.

Conditions stipulated by the Commissioner | Here i āta whakaritea e te Kaikōmihana

This Ruling is made subject to the following conditions:

(a) Any Scheme Participation Agreement (Employer Contract), Scheme Participation Agreement (Dealer Contract) and Salary Sacrifice Agreement entered into by the parties will be materially the same as the versions provided to the Tax Counsel Office on 16 February 2025.

(b) Any Employer Bike Purchase Scheme Policy entered into by the parties will be materially the same as the second version provided to the Tax Counsel Office on 28 March 2025.

(c) The Employee enters into a Salary Sacrifice Agreement for the bond period in advance of them earning their income in, or for, the bond period.

How the Taxation Laws apply to the Arrangement | Ko te pānga o ngā Ture Tāke ki te Whakaritenga

Subject in all respects to any conditions stated above, the Taxation Laws apply to the Arrangement as follows:

ITA

(a) The provision of the Equipment by the Employer to an Employee under the Salary Sacrifice Agreement and the Scheme Policy is an excluded fringe benefit under s CX 19D and is therefore not a fringe benefit under s CX 2.

(b) The provision of the Equipment to an Employee will be an excluded fringe benefit under s CX 19D at the time that the Equipment is provided to the Employee.

(c) There are no on-going requirements for the Employer to monitor use of the Equipment for the purposes of s CX 19D.

(d) There is a valid salary sacrifice under the Salary Sacrifice Agreement so the amount of salary sacrificed is not a PAYE income payment under s RD 3.

(e) The Arrangement is not a tax avoidance arrangement under s BG 1.

GSTA

(f) If the Employer is registered for GST, the Employer can claim the GST charged by The Wheel Deal on the purchase of the Equipment under the Scheme as input tax (as defined under s 3A(1)) under ss 20(3) and 20(3C) to the extent to which the Equipment is used for making taxable supplies.

(g) If the Employer is registered for GST, the sacrifice of salary under a Salary Sacrifice Agreement is consideration for a taxable supply by the Employer to the Employee under s 8(1) of procuring the provision of the Equipment to the Employee. The value of the supply for the purposes of s 10(2) is the amount of the salary sacrificed.

(h) The Arrangement is not a tax avoidance arrangement under s 76.

Period or income year for which this Ruling applies | Te wā, te tau moni whiwhi rānei i pāngia ai e tēnei Whakataunga

This Ruling will apply for the period beginning on 17 February 2025 and ending on 2 April 2028.

This Ruling is signed by me on the 3rd day of April 2025.

Dinesh Gupta

Tax Counsel Lead | Rōia Kaihautū Tāke

Tax Counsel Office | Te Tari Tohutohu Tāke

OPERATIONAL STATEMENTS

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

OS 25/01: Cash collateral is "money lent"

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

Introduction

The Commissioner has previously taken the view that payments of money in the form of cash (cash collateral) as part of, and to secure obligations under, security lending and derivative transactions was not money lent so there was no RWT or NRWT withholding obligation for the interest payments arising.

The Commissioner has changed his view and this operational statement sets out the approach that the Commissioner will be taking to the arrangements in question, going forward and for previous periods.

The Commissioner's view

1. This statement covers arrangements involving payment of amounts of money in the form of cash to act as security to cover the exposures of a party from obligations under security lending or derivative transactions using market standard documented agreements. Specific examples of such agreements considered by the Commissioner are (for security lending) the International Securities Lenders Association Global Master Securities Lending Agreement and (for derivatives) the International Swaps and Derivatives Association Master Agreement together with a Credit Support Annex stipulating the terms governing the posting of collateral.
2. The payments are referred to as "cash collateral".
3. The agreements governing the arrangements generally contractually oblige parties to make further payments (described as interest) based on the value of the cash collateral held. Whether such further payments create withholding obligations for RWT or NRWT depends on whether they are "interest" for the purposes of the definitions of "resident passive income" in s RE 2 and "non-resident passive income" in s RF 2. Whether they are "interest" depends on whether the cash collateral is "money lent" as that term is defined in s YA 1.
4. The Commissioner's view is that in the agreements he has considered the cash collateral is a loan, and therefore money lent, because there is a transfer of money with an obligation to repay. The arrangements in question require a party to pay an amount in circumstances where an equivalent with interest needs to be repaid. Further, the composite nature of the contractual arrangements does not have the consequence that the cash collateral is not money lent.
5. This means that a party to the arrangement who is a payer of interest on the cash collateral should, unless the payee has RWT exempt status, withhold RWT or NRWT (depending on the residence of the payee) and pay it to Inland Revenue.
6. For the avoidance of doubt, this is the position for interest that is specific to the cash collateral. This Statement does not cover interest that might be said to be a component of the pricing of other elements of the broader arrangement such as derivatives or shares.
7. The view outlined above is different to the view the Commissioner has taken previously at an individual customer level. For some time, although the Commissioner has accepted customers taking the position that cash collateral is not money lent, the correct approach has been considered to be uncertain. Having undertaken further thinking on the issue, the Commissioner has come to the conclusion outlined above.

Application

8. This statement applies from the date of issue.
9. However, the conclusion that cash collateral is money lent will be applied prospectively and to allow customers to make the required changes to their systems and any alternative arrangements, the Commissioner expects customers to comply with the new view when taking tax positions from 1 April 2025. The Commissioner will not be devoting resources to identifying incorrect compliance with the RWT or NRWT regimes for previous periods.

Maria Szymanik

Technical Lead, Legal Services

Date of Issue: 18 March 2025

OS 25/02: Valuation of livestock

Issued: 31 March 2025

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

This statement describes the options available for taxpayers who are in the business of farming to value the livestock they have on hand at balance date.

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

START DATE
31/03/2025

REPLACES

- Income Tax Act 1976 *Tax Information Bulletin* Vol 5, No 10 (March 1994): 8 at 9 (access to herd scheme)
- Access to herd scheme *Tax Information Bulletin* Vol 5, No 10 (March 1994): 9
- Livestock valuation at farmer's death *Tax Information Bulletin* Vol 6, No 14 (June 1995): 26
- Livestock valuation – election of method *Tax Information Bulletin* Vol 16, No 5 (June 2004): 41
- Livestock valuation – previous years' invalid elections *Tax Information Bulletin* Vol 16, No 5 (June 2004): 45
- Values placed on exotic livestock *Tax Information Bulletin* Vol 7, No 2 (August 1995): 30
- Valuing livestock when estate continues farming activity previously carried on by deceased *Tax Information Bulletin* Vol 7, No 2 (August 1995): 30

Key terms

A **taxpayer** or a **farmer** means, solely for the purposes of this statement, a taxpayer or a farmer who is in the business of farming livestock.

Class of livestock means one of the categories for a type of livestock listed in column 2 of sch 17 (types and classes of livestock). For instance, the classes of sheep are ewe hoggets, ram and wether hoggets, two-tooth ewes, mixed-age ewes, rising 5-year and older ewes, mixed-age wethers and breeding rams.

Farming means, solely for the purposes of this statement, the business of rearing and growing livestock for the purpose of selling that livestock or their bodily produce.

Livestock means, solely for the purposes of this statement, all live animals the breeding of which is regulated by humans and are held as assets of a farming business.[1]

Non-specified livestock means livestock other than bloodstock, high-priced livestock and specified livestock.

Specified livestock means an animal of a type specified in column 1 of sch 17 (types and classes of livestock): beef cattle, dairy cattle, deer, goats, pigs and sheep. It generally does not include an animal that is high-priced livestock.[2]

Type of livestock means a category of livestock listed in column 1 of sch 17 (types and classes of livestock). These types are beef cattle, dairy cattle, deer, goats, pigs and sheep.

1 *Land Projects Ltd v CIR* [1964] NZLR 723; *Peterborough Royal Fox Hound Show Society v IR Commrs* [1936] 1 All ER 813. See also *Wardhaugh (AF) Ltd v Mace* [1952] 2 All ER 28 at 31.

2 Except as provided for in s EC 37 (bailments).

Introduction

1. Historically, for tax purposes, "livestock" was included in the definition of "trading stock". As a result, any business taxpayer that held livestock for sale or exchange as part of their business was required to:
   - include as income, an amount equal to the value of the livestock that they had on hand at balance date; and
   - value that livestock using one of the valuation options available to all business taxpayers to value their trading stock, or at a standard value issued by the Commissioner.
2. Standard values were generally set when a farming business began, and they remained at that set level for the life of the farming operation.
3. In its May 1986 report, the Consultative Committee on Primary Sector Taxation recommended the government allow livestock to be valued using methodologies specific to livestock.[3] The government accepted this recommendation, with effect from the 1987 income year.
4. The enactment of the Income Tax Act 2004 saw the removal of livestock from the definition of trading stock. What remains is the requirement for taxpayers that hold livestock for the purposes of farming that livestock as part of their farming business[4], to value that livestock at the end of each income year using one of the available livestock valuation methods.[5]

Livestock required to be valued

5. Section EC 1 provides that all livestock that is held for the purposes of farming them as part of a farming business is subject to valuation in accordance with the rules in subpart EC. Bailors of livestock, although they may not meet all these requirements, are specifically included. However, livestock held as part of a business of dealing in livestock is excluded. Section EC 1 is reproduced in the Appendix to this statement.
6. For the purposes of this statement, the words farming and livestock are defined in the key terms section earlier in this statement. From the wording of s EC 1 and these definitions, the following matters need to be noted:
   - Animals must be living to fall within the definition of **livestock**. This means unborn animals (eg, unhatched eggs) are excluded from the definition of livestock.[6, 7]
   - It is not sufficient that a farmer merely owns livestock. This is so even where the farmer rears this livestock and/or uses that livestock in the farming business. To come within the definition of livestock, the livestock must be "farmed" by the farmer; that is, reared for sale (or the sale of their bodily produce) as part of the farming business. Because of this, livestock that are not farmed do not require valuation. Examples include:
     - livestock raised for home consumption (or for their produce such as chicken's eggs or cow's milk);
     - working horses or dogs used on the farm; and
     - household pets.

     If the nature of the farming operation changes such that any of these animals start to be farmed as part of a farming business, then valuation would be required. An example of this could be where a farmer starts a business involving the breeding, rearing and sale of working dogs.
   - It is not sufficient for the livestock to merely reside on the farming property. They must be farmed as part of the farming business. Therefore, for instance, any feral animals (deer, pigs, goats etc) residing on the farming property do not require valuation, unless the farmer incorporates them into the farming business and begins to farm these animals.

3 Consultative Committee on Primary Sector Taxation, *Report of the Consultative Committee on Primary Sector Taxation* (Inland Revenue, Wellington, May 1986)

4 Section EC 1.

5 Section EC 2(1).

6 Ostriches and emus – valuation for income tax purposes *Tax Information Bulletin* Vol 9, No 8 (August 1997): 11.

7 Where eggs are sold as part of a business of trading in eggs, eggs on hand at balance date, while not livestock, do come within the definition of trading stock and need to be valued using the trading stock rules in subpart EB.

Options available to value livestock

7. The options available to taxpayers to value livestock on hand at the end of an income year are for:[8]
   - **specified livestock**, one of the following methods:[9]
     - the national standard cost (NSC) scheme (discussed from [19]);
     - the herd scheme (discussed from [32]);
     - another valuation method – cost price, replacement price or market value (discussed from [72]; or
     - a formula available to the bailee of bailed livestock (bailed livestock is discussed from [98]);
   - **non-specified livestock**, one of the following methods (discussed from [86]):[10]
     - cost price;
     - replacement price;
     - market value; or
     - with the Commissioner's consent, its standard value;
   - **high-priced livestock**,[11] the livestock's cost price less a depreciation percentage determined by the Commissioner (discussed from [68]); and
   - **bloodstock**,[12] generally its cost price (discussed from [93]).

Discussion

Specified livestock – electing a valuation method

8. In their first year of business, a taxpayer must decide which valuation method they will use to value their specified livestock; the taxpayer "elects" to use a certain option (or options). For all options except the herd scheme this is done simply by the taxpayer using the chosen method in their return of income for the income year.[13] Those who wish to use the herd scheme for a type of livestock must provide notice to the Commissioner.
9. Owners of specified livestock that are also high-priced livestock or bailed livestock do not have a choice of valuation method. The methods are set by legislation and are discussed in later paragraphs.
10. When a taxpayer chooses a valuation method, that method continues to apply in each of the following income years unless they choose another method that is available to them. The taxpayer must satisfy the relevant requirements for the use of the other method.[14]

Types of election

11. How a taxpayer makes an election varies depending on what the taxpayer is electing to do. For instance, some elections allow taxpayers to "choose" what they wish to do and to then advise the Commissioner of this choice by taking the relevant position in their income tax return.
12. Some elections require the taxpayer to "notify" the Commissioner in the same year that the taxpayer wishes their election of method to be effective. Where this requirement exists, a taxpayer must notify the Commissioner by the date of filing their return of income for the income year in which the election is first to apply. Taxpayers may "notify" the Commissioner electronically (by email or myIR) or in writing.[15] Merely taking the relevant position in their income tax return is not sufficient. Unless legislation specifically requires a taxpayer to provide an election to the Commissioner in writing, the Commissioner accepts that such notification is not required.

8 Introduced by s 20 of the Income Tax Amendment Act (No 2) 1993 and ss 20 to 26 of the Income Tax Amendment Act (No 3) 1993.
9 Section EC 7.
10 Section EC 30.
11 Sections EC 33 and 34.
12 Sections EC 38, EC 39, EC 39B, EC 39C, EC 40 to EC 47, EC 47B, EC 47C, EC 47D and EC 48.
13 Section EC 7(2).
14 Section EC 7(3).
15 Sections 14C(2) and 14F(3) of the Tax Administration Act 1994

13. Some elections require the taxpayer to notify the Commissioner 2 years before the income year in which the election is to become effective. As with same-year elections that are discussed above, the taxpayer must notify the Commissioner electronically or in writing. However, in these cases the taxpayer must notify the Commissioner by the date of filing their return of income for an income year that is at least two income years before the income year in which the election is to first apply.

Situations that do not require the Commissioner to be notified

14. Examples of situations that do not require the Commissioner to be notified in writing are where the taxpayer:
    - is electing which valuation method(s) to use in their first year of farming specified livestock (other than for the use of the herd scheme), as stated at [8];
    - has adopted the herd scheme and is using an alternative valuation option to value livestock of a class (see further from [42]);
    - moves additional livestock onto the herd scheme from an alternative valuation option, where the herd scheme is already being used to value some livestock of that same type; or
    - is moving between the cost price, market value and replacement price methods.

Situations that require the taxpayer to "notify" the Commissioner in the same year

15. Situations that require a taxpayer to notify the Commissioner in the same year that the taxpayer wishes their election to be effective include when the taxpayer wishes to:
    - value livestock of a particular type under the herd scheme (discussed further at [34]);[16]
    - use a herd value ratio or Chatham Islands adjustment in the first year they elect to value livestock using the herd scheme[17] (see more on the herd value ratio (and recalculated ratio) from [45] and the herd value ratio Chatham Islands adjustment from [52]); and
    - exit the herd scheme when all female breeding stock are to be used in a fattening business[18] (further discussed at [39]).

Situations that require the taxpayer to provide 2 years notice to the Commissioner

16. Situations that require a taxpayer notify the Commissioner 2 years before the income year in which the election is to become effective include when the taxpayer is electing to:
    - adopt a herd value ratio or Chatham Islands adjustment, or recalculating either ratio, after adopting the herd scheme (see further from [45]);[19] or
    - changing between the cost price and NSC methods[20] (see further at [30]).

Information requirements for notices of election

17. All notices of election must be provided electronically or in writing and must include the:[21]
    - first income year in which the election is to apply;
    - type, class or other description of the applicable livestock;[22] and
    - existing and proposed methods of valuing the applicable livestock.

16 Section EC 11(2)(a).

17 Section EC 11(2)(b).

18 Section EC 11(2)(c).

19 Section EC 11(3)(b).

20 Section EC 11(3)(c) and (d).

21 Section EC 11(4).

22 What the **description of the applicable livestock** should be depends on the valuation method being elected. When the method chosen allows only for election by type or class, then type or class is the appropriate description. If the method chosen allows for some livestock of a class to be elected to a scheme, then the type, class and number of livestock is the appropriate description.

18. For an election to use a herd value ratio or recalculated herd value ratio, the notice of election must also include the:
    - assessed value of an average animal of each applicable class of livestock;[23]
    - date on which the valuation of each animal was made; and
    - valuer's name and address.

National standard cost scheme

19. In its final report to the Ministers of Finance, Agriculture and Forests, the Consultative Committee on Primary Sector Taxation described the cost options that should be available for farmers to value their livestock:[24]

> Our suggestion is that taxpayers who wish to adopt the cost option be entitled to use one of the following methods of arriving at the cost of **farm bred stock only**:
>
> actual cost, based on specified costing systems and records,
>
> …
>
> Purchased stock, whether high-priced or other, would be brought in at actual cost.

20. The committee added:

> The Consultative Committee has been advised that the greatest part of the cost of "growing" an animal (as distinct from maintaining it) occurs during its first two years of life (first year for pigs).
>
> …
>
> Any rule about cost accumulation can only be arbitrary. As an arbitrary rule, therefore, we suggest that for farm-bred animals, cost should be accumulated to the point of maturity, set at first balance date after birth for pigs, second balance date after birth for all other species.

21. This 1986 committee was describing what is now the cost price method (further discussed from [72]). However, the subsequent Consultative Committee on Livestock Valuation in 1992 adopted these same requirements for a new NSC scheme that was introduced with effect from the 1993 income year.[25]
22. The two cost schemes have one main difference. Namely, the farmer self-assesses the cost price method and that assessment reflects their personal farm costs of production, whereas the Commissioner determines the values used in the NSC scheme and they reflect national average costs of production.

NSC values

23. The Commissioner determines NSC values and generally publishes them in February each year. The values determine the national average cost of producing livestock to a mature state – that is, the costs of production. Schedule 18 sets out the livestock for which the Commissioner must determine NSC values.
24. For most types of specified livestock, the Commissioner determines the national average cost of:[26]
    - breeding, rearing and growing rising 1-year-old stock of each type (BRG costs); and
    - rearing and growing rising 2-year-old stock of each type (RG costs).
25. Separate cost figures are determined for: purchased bobby calves, 3-year-old male, non-breeding cattle, weaner pigs up to 10 weeks of age, and growing pigs aged 10 to 17 weeks.[27]
26. The NSC values the Commissioner determines reflect the national average costs of production of the various types and classes of immature livestock at each stage of their growth. Farmers using the scheme apply the BRG costs to rising 1-year stock bred on the farm during the year and the RG costs to immature animals on hand at the beginning of the year (rising 2-year stock). The actual cost of acquisition is used to value any immature livestock the taxpayer purchased during the year.
27. The weighted average of these two costs (the NSC values the Commissioner determines and the purchase price of

23 Section EC 17(4).

24 Consultative Committee on Primary Sector Taxation, *Report of the Consultative Committee on Primary Sector Taxation* (Inland Revenue, Wellington, May 1986) at 25, 26.

25 Consultative Committee on Livestock Valuation, *Report of the Consultative Committee on Livestock Valuation* (Inland Revenue, Wellington, September 1992).

26 The exceptions are beef cattle and dairy cattle, for which the Commissioner determines three costs.

27 Suckling pigs are valued at nil for tax purposes.

immature livestock the taxpayer acquires) is used to calculate the final closing value of immature livestock on hand. Once livestock reaches maturity, each animal holds that cost until disposal and no further RG costs are allocated to them. This is illustrated in Example 1.

Example 1: Calculating the closing value of immature livestock

The calculation for rising 1-year livestock starts with the formula:

((homebred numbers × BRG cost determined by the Commissioner) plus total purchase costs) ÷ homebred numbers plus purchase numbers

The farmer has homebred 1,250 lambs in the 2023 income year and purchased a further 500 hoggets for $30,000. Therefore, the final closing value for these rising 1-year animals is:

Number	Calculation	$
1,250	Homebred rising 1-year x BRG for the 2023 income year ($47.50)	59,375.00
500	Purchase cost of rising 1-year hoggets	30,000.00
1,750	**Amount included in tax accounts**	**89,375.00**

This represents an average cost per head of $51.07 ($89,375 ÷ 1,750).

28. When the NSC scheme was introduced, Inland Revenue and the then New Zealand Institute of Chartered Accountants[28] developed the methodology for calculating the national average cost of production for each type of immature livestock (the BRG and RG costs).

29. The NSC values determined include not only the direct costs of breeding, rearing and growing rising 1-year and 2-year livestock (feed and vet fees for example) but also the indirect costs incurred in undertaking these activities (eg, wages, freight, seed and fertiliser costs, repairs and maintenance costs, and depreciation). The costs determined exclude costs incurred in owning (or leasing) and operating the farm business. They also exclude the costs of operating non-livestock enterprises (such as cropping) and direct costs associated with producing and harvesting any of the livestock's dual products (depending on the type of animal, this might be the production of meat, wool, fibre, milk or velvet).

Elections to enter and exit the NSC scheme

Restrictions on entering the NSC scheme

30. Taxpayers may choose to value specified livestock under the NSC scheme, without providing a written election to the Commissioner, unless:
    - the taxpayer is using the cost price method to value any livestock in the same income year;[29]
    - the taxpayer used the cost price method to value any livestock in the preceding year and has not given at least 2 years' written notice of their intention to value specified livestock under the NSC scheme;[30]
    - specified livestock has been made available to another person under a profit-sharing arrangement and, in the income year, the other person values any livestock of that type under the cost price method;[31]
    - the taxpayer has bailed or leased livestock to another person under a long-term bailment (ie, not a profit-sharing arrangement);[32]
    - the livestock is of a type or class that is not included in sch 18 (categories of livestock for which national standard costs to be declared);[33] or

28 Now Chartered Accountants Australia and New Zealand (CA ANZ).
29 Section EC 9(1).
30 Section EC 9(2).
31 Section EC 9(3).
32 Section EC 9(4).
33 Section EC 9(5).

- the livestock is male breeding stock, where livestock of the same type is valued under the herd scheme in an income year; this is so even where some livestock of that same type have been valued using the NSC scheme.[34]

Exiting the NSC scheme

31. Taxpayers may exit the NSC scheme without providing written notice, except that they must give:
    - written notice in the same year to move livestock of a particular type from the NSC scheme to the herd scheme;[35] and
    - 2 years' written notice to move from the NSC scheme to the cost price method.[36]

Herd scheme

32. In its final report, the Consultative Committee on Primary Sector Taxation described the herd scheme as follows:[37]

> The herd scheme is intended to reflect the fact that in some respects a herd or flock can be likened to a "machine". The "machine" is a relatively fixed asset, owned and maintained for the sale value of what it produces, rather than for its own inherent sales value. The herd scheme exempts from tax any inflationary gains on the realisation of the "machine" over and above its "cost", but rather than permitting annual depreciation, the scheme gives tax deductions for the annual cost of "repairs and maintenance" i.e. the difference between the replacement animals and the proceeds from the sale of the stock replaced.

33. The means of excluding these "inflationary gains" for tax purposes is to attribute the same value to the specified livestock on hand at both the opening and closing balance dates of the farmer. In this way, it is only an increase or decrease in the value of livestock numbers over the income year that affects a taxpayer's taxable profit (or loss).

Herd scheme values

34. Each year, the Commissioner must determine the national average market values (NAMVs) of all types and classes of specified livestock that are to be valued under the herd scheme for an income year.[38]
35. To ascertain the NAMVs of the various classes of livestock, the Commissioner contracts with highly experienced livestock valuers situated throughout the country.[39] Each valuer is asked to provide the market value of the various livestock classes in a specified region. Generally, more than one valuer is contracted for each region. The market valuations required are for good quality, on-farm animals (capital stock) on 30 April.
36. From these valuations, the Commissioner calculates the NAMV for each livestock class. In the case of the sheep, beef, dairy cattle and deer (red, wapiti and elk) classes, a weighted average is used against the values each valuer produces. The weighted average is calculated based on total livestock numbers for a type of livestock in a particular region compared with the national herd numbers for that type of livestock.[40] Because of their comparatively low numbers, a straight average is used for the remaining livestock types, except "other deer". The value of other deer is taken as the mid-point between the trophy and meat market values.
37. The NAMVs that are determined are published (generally in May each year) and apply to the income year for which they are determined, irrespective of whether that income year started before, on or after the date on which the Commissioner made the determination.[41]

34 Section EC 8(6).

35 Section EC 11(2)(a).

36 Section EC 11(3)(d).

37 Consultative Committee on Primary Sector Taxation *Report of the Consultative Committee on Primary Sector Taxation* (Inland Revenue, Wellington, May 1986) at 17.

38 Section EC 15(1).

39 Usually this involves gaining valuations from 38 valuers.

40 Stats NZ collates livestock numbers.

41 Section EC 15(2).

Elections to enter and exit the herd scheme

Entering the herd scheme

38. An election to enter the herd scheme may be made in relation to only a "type" or "class" of livestock;[42] for instance, all dairy cattle or a class of dairy cattle (mixed-age cows)). An election cannot be made in respect of partial class; x number of mixed-age cows for example. As stated at [15], same-year written notice is required for the taxpayer to enter the herd scheme. This is so even in the first year of business, which is not the case for other valuation options. The reason for this is that an election to enter the herd scheme is largely irrevocable.[43] Therefore, the taxpayer should have turned their mind to the consequences of using this option. The contents of a notice of election are discussed at [17].

39. A taxpayer can exit the herd scheme if at least one of the following criteria is met:[44]
    - A taxpayer can exit if they are going to stop using all female livestock for breeding and, instead, will use them in a fattening operation. The taxpayer must provide the Commissioner with same-year notice (this is further at [12]).
    - A taxpayer can exit if the number of animals in a class has increased in an income year. To the extent of that increase, the taxpayer may use an alternative valuation option. The taxpayer is not required to provide notice to the Commissioner (further discussed at [14] and [44]).

40. Even if a taxpayer meets one of these criteria, if livestock of a particular type is valued under the herd scheme, all male breeding stock of that type must be valued under the herd scheme.

41. Despite these restrictions, a taxpayer may still elect to adopt a herd value ratio or recalculated herd value ratio or the Chatham Islands adjustment for any livestock type. An election to use one of these valuation options must be made 2 years before the income year in which the valuation method is to become effective.[45]

Use of an alternative valuation option

42. As stated at [39], where a taxpayer is valuing livestock under the herd scheme and the number of livestock in a class increased in an income year, then, to the extent this "base number" has increased, a taxpayer may use an alternative valuation option to value that increase.

43. In calculating the amount of any increase in livestock numbers, a farmer must take last year's closing stock numbers for a class and add to that number the number of any livestock of that class acquired from an associated person,[46] where that associated person acquisition was not made in the ordinary course of business and was from a person that used the herd scheme to value that livestock.[47] The section of the Act that contains the formula to be used (s EC 8) is reproduced in the Appendix. Whether an acquisition has been made in the ordinary course of business is further discussed from [56] and in Example 2.

42 Section EC 14(1).
43 Section EC 7(3).
44 Section EC 8(1).
45 Section EC 11(3)(b).
46 Section EC 8(4).
47 Section EC 4B.

Example 2: Using an alternative valuation option

Jim is a dairy farmer. He is considering whether he can use an alternative valuation option in relation to an increase in the number of mixed-aged cows in his herd. This year, due to his acquisition of an adjoining block, these numbers have increased from 350 to 450.

Complicating his decision is the fact that during the year he acquired 60 cows from his father and this acquisition was not made in the ordinary course of his father's business. To see whether he may use an alternative valuation option, Jim must first calculate a base number that can be compared with his current herd number. Jim's base number is:

Category	Number
Mixed-aged cows on hand at the end of the previous year*	350
Mixed-aged cows acquired from associated person	60
Base number	**410**

* Although s EC 8(4) and (5) refers to animals of the relevant class that the person valued under the herd scheme at the end of the year before the current year, this equates to the livestock of that class on hand at the start of the current year.

As the number of mixed-aged cows Jim now owns (450) exceeds this base number (410), he may use an alternative valuation option in relation to 40 cows.

44. If a taxpayer meets the requirements to use an alternative valuation option, the Commissioner is not required to be notified of the decision to use the alternative option.

Herd value ratio (and recalculated ratio)

Option available if the market value of a farmer's livestock differs from the NAMV

45. As described from [34], NAMVs provide the **national** average market value for the specified livestock types and classes. Because of this, they may not always reflect the average market value of the livestock of a particular taxpayer or even of a particular region. Where a farmer believes the average market value for their type of livestock regularly differs markedly from the NAMVs determined by the Commissioner, they may elect to use a herd value ratio to reflect more accurately the value of their livestock. They can apply a ratio to only an entire type of livestock rather than to individual classes within that type.[48]

46. A farmer may recalculate the herd value ratio if they believe their current ratio no longer reflects market value. The Commissioner may also require a ratio to be recalculated for the same reason.[49]

47. The ratios that can be used are 0.9 (90%), 1.0 (100%), 1.1 (110%), 1.2 (120%) and 1.3 (130%) of the NAMVs determined in that income year.[50] The section of the Act containing the formula for calculating a herd value ratio (s EC 17) is reproduced in the Appendix. The herd value ratio that may be used is the one that is the closest match to the market value of the applicable livestock.

48. The farmer needs to obtain a valuation from a recognised livestock valuer. The valuation must be that of an **average animal** for each class, of each type of specified livestock for which a herd value ratio is intended to apply. It cannot be the average of all the livestock of that class the taxpayer owns.[51]

49. As with the values the Commissioner obtains to calculate that year's NAMVs, the taxpayer must carry out their herd value ratio valuation on 30 April **in the year they elect to adopt a herd value ratio.**[52]

48 Section EC 17(1).
49 Section EC 18.
50 Section EC 17(5).
51 Section EC 17(4).
52 Section EC 17(4).

Elections to use or recalculate a herd value ratio

50. Where a taxpayer elects to use a herd value ratio before adopting the herd scheme, written notice to the Commissioner is required in the same year that the herd value ratio is first used.[53] Once a taxpayer has adopted the herd scheme, they must give 2 years' written notice to adopt or recalculate a herd value ratio.[54] The contents of elections were discussed at [17].

51. As stated above, a taxpayer using the herd scheme to value a type of livestock must obtain a valuation at the time they elect to use a herd value ratio for that type of livestock. Effectively, this means that valuation must be obtained 2 years before the taxpayer uses that herd value ratio. Example 3 illustrates the factors farmers must weigh up in using a herd value ratio.

Example 3: Using a herd value ratio

Mary and Tony are King Country sheep farmers. Their livestock is valued under the herd scheme. They believe the NAMVs for sheep that the Commissioner has determined historically have been higher than the market value of their livestock. The reason for the difference may be that their farm is located on rough hill country.

They are aware that before they can elect to use any of the available herd value ratios, they must obtain a valuation from a recognised livestock valuer that justifies their use of a particular ratio. In discussing herd value ratios with them, their agent emphasises that they must make it clear to the valuer that the valuation they wish to obtain is **not** one that provides the average value of each of their livestock classes; rather, the valuation must be that of an average animal in each class on 30 April of that year.

The valuations Mary and Tony obtained showed that, while the average animal value in all classes of their livestock was below the NAMVs the Commissioner determined for that year, most were only marginally so. Only the value of their two-tooth and mixed-age ewes are sufficiently lower to justify a herd value ratio of 0.9. A ratio of 0.9 (or 90%) is the only available ratio that is less than the declared NAMVs.

Because Mary and Tony are already using the herd scheme to value their livestock, their agent advises them that if they want to use this ratio, they must elect to do so 2 years before they apply the ratio. As Mary and Tony believe the ratio is historically accurate (and will remain so), they decide to go ahead with their election.

In discussing this matter with the farmers, their agent also points out that if the reduced values were of short duration (because of the effect of an adverse event on their livestock for instance), using a ratio would not have been useful. This is because the livestock values would be expected to return to normal within the 2-year election period.

Herd value ratio – Chatham Islands adjustment

52. Due to their low values, specified livestock that are on the Chatham Islands at the end of an income year may be subject to a **Chatham Islands adjustment.** Only farmers on the Chatham Islands may elect to use this adjustment.[55] This adjustment is an extension to the herd value ratios that may otherwise apply and that the Commissioner determines from time to time. The adjustment to the herd value ratio is 0.3 (30% of the NAMV for specified livestock set each year). This adjustment applies to only sheep and beef cattle.[56]

53. The election requirements for the Chatham Islands adjustment are the same as those for a herd value ratio (discussed from [50]).

53 Section EC 11(2)(b).

54 Section EC 11(3)(b).

55 Section EC 19.

56 Livestock values – Chatham Islands, Appendix Tax Information Bulletin Vol 5, No 2 (August 1993): 22.

Sales to associated parties

54. Where a transfer of specified livestock occurs between associated parties and that livestock has previously been valued using the herd scheme, the associated party acquiring the livestock must continue to use the herd scheme to value that stock.[57] The party acquiring the livestock also assumes the same position as the original owner in relation to the previous herd scheme election, herd scheme base number and herd scheme values. This rule applies even where the transfer is made under the Property (Relationships) Act 1976.[58]

55. This general rule has three exceptions: sales made in the ordinary course of business; intergenerational transfers; and deceased estates.

Sales made in the ordinary course of business

56. The first exception relates to sales made in the ordinary course of business.[59] The Commissioner acknowledges that associated parties may trade among themselves in the ordinary course of carrying on their businesses. These sales are not affected by the general rule.

57. Given the large number of scenarios that could exist in this area, what constitutes "the ordinary course of business" is left to the judgement of the parties to the transactions, rather than being defined by legislation.

Intergenerational transfers

58. The second exception relates to intergenerational transfers.[60] It applies when livestock is transferred to the son, daughter or grandchild of the original owner and the:
    - recipient did not have an interest in the livestock before transfer;
    - transfer is at market value on commercial terms and conditions (other than financing); and
    - original owner has disposed of all specified livestock and does not derive income from specified livestock for the following 4 years.

59. To make this work, a complicated application of the associated person rules is needed. Essentially, where the **only** connection between the parties is this blood relationship, the exception can apply. As noted above, the recipients of the livestock cannot have an interest in the livestock before transfer.

60. The original owner of the livestock must stop deriving income directly or indirectly from the disposal of specified livestock, which is part of a business, for the next 4 years. This doesn't mean they must dispose of all their livestock; rather, they must not use any remaining livestock in a business.

61. For instance, the vendor could graze a few animals on a lifestyle block for personal consumption. They could retain only the land and enter into a 50:50 sharemilking arrangement, or start farming non-specified livestock, all without disturbing the exception.

62. The word "indirectly" refers to the situation where the livestock are owned by a trust or company the vendor is associated with.

63. The 4-year period was chosen because it should be long enough to confirm there was a genuine intention to cease deriving income from specified livestock.

Deceased estates

64. The third exception relates to deceased estates.[61]. The rule here is that the intergenerational transfers exception applies unless the will creates a life interest in the relevant livestock.

65. Example 4 and Example 5 illustrate two scenarios involving sales to an associated party. For more information about sales to associated parties, see **Associated party transfers of herd scheme livestock**.[62]

57 Section EC 4B(1).
58 Section FB 15.
59 Section EC 4B(1).
60 Section EC 4B(2).
61 Section EC 4B(3).
62 Associated party transfers of herd scheme livestock *Tax Information Bulletin* Vol 25, No 9 (October 2013): 4.

Example 4: Sales to an associated party in the ordinary course of business

George is a dairy farmer. His son, Tahi, recently acquired a block of land near the family farm on which he is establishing a beef-fattening operation. Tahi values his livestock using the NSC valuation option, while his father values his dairy herd using the herd scheme option.

One way Tahi acquires stock is by purchasing his father's unwanted rising 1-year steers. Tahi acquires this stock at market value, while George provides loan finance so his son can acquire the livestock.

In this circumstance, as Tahi's father is disposing of his rising 1-year steers as part of his usual business operations and Tahi is acquiring the livestock at market value, the Commissioner would accept that the transfer of livestock has occurred in the ordinary course of business. The fact the acquisition has been funded with finance George has provided is not relevant to this outcome.

Therefore, Tahi is free to value the acquired livestock using a valuation option other than the herd scheme (which the livestock had previously been valued under).

Example 5: Sales to associated party by intergenerational transfer

Some years have passed since the scenario in Example 4 occurred. While Tahi's fattening operation is now well established, George has decided it is time he retired.

George would like the farm to remain in family hands, so he approaches Tahi with the proposition that Tahi takes over the family dairy farm on normal commercial terms with financial assistance from George. Tahi agrees to do this.

Tahi remembers the previous discussion about acquiring livestock from an associated person. In discussing the proposed change of ownership with their agent, he asks if he will have to use the herd scheme to value the dairy herd that he will be acquiring in this new scenario. The agent first asks George and Tahi whether the transfer will be at market value on usual commercial terms. After they confirm it will be, the agent advises Tahi that if George gives up any business of farming specified livestock for at least 4 years, Tahi can use a valuation option other than the herd scheme to value the dairy herd.

Farmer disposes of livestock before Commissioner determines NAMVs

66. Where, in an income year, a farmer ceases to derive income from the sale of specified livestock and disposes of that livestock before 1 November that precedes the determination of the NAMVs for that income year, the opening value of that specified livestock is:[63]
    - the opening value of the livestock for the previous income year; or
    - if a herd value ratio has been adopted, the herd value multiplied by the herd value ratio applying in the previous income year.

67. Note that, as discussed at [54], this treatment may not apply if the disposal is to an associated person.

High-priced livestock

68. "High-priced livestock" is defined as being specified livestock that are purchased for at least $500 per head **and** cost at least five times the national average market value that the Commissioner determined for that class of specified livestock in the year of acquisition or the previous year, whichever value is higher. Further, on acquisition, the animal must be capable of being used for breeding or, if it is immature, it must be expected to be capable of being used for breeding when it reaches maturity.[64]

63 Section EC 20(1) and (2).

64 Section YA 1.

69. High-priced livestock must be valued at its cost price. Mature, high-priced livestock are valued at cost less an amount of depreciation, for which the Commissioner sets the rate.[65] Immature high-priced livestock (less than 1 year old at the end of the year of acquisition) are valued at cost price and may not be depreciated until they reach maturity. For the current depreciation rates, see the section on **assigned percentages of high-priced livestock** in **Average market values of specified livestock – 1996.**[66]
70. Taxpayers must choose either the straight-line method or the diminishing value method of depreciation.[67] If a taxpayer chooses the diminishing value method, they must notify the Commissioner of this (by email or myIR or in writing[68]) at the time of filing the first income tax return of income that uses the high-priced scheme. The decision to use the diminishing value method is irrevocable [69]
71. Each head of stock remains high-priced livestock until the:
    - year in which the depreciated value for that livestock is equal to or below the level of the NAMVs the Commissioner determines for that class of livestock;[70] or
    - taxpayer no longer expects to use that livestock for breeding or intends to sell the livestock to another person for breeding purposes.[71]

    At either time, the high-priced livestock reverts to being ordinary specified livestock and is generally valued using the method that the taxpayer is already using to value other livestock of that type.[72] This is illustrated in Example 6.

Example 6: Valuation of high-priced livestock

Aisha purchased a Romney ram for $2,200 during the 2019–20 income year. The NAMV for rams that year was $340 and $338 in the previous income year. As Aisha's ram was acquired for more $500 **and** more than five times the higher of these values, the Romney ram needs to be valued using the high-priced valuation method.

Aisha decides to use the straight-line method to calculate the depreciating value of the ram. For sheep, the straight-line depreciation rate is 25% per annum. In the following years the written down value of the ram will be:

Income year	Written down value ($)
2020	1,650
2021	1,100
2022	550

Due to decreased performance, the decision is made during the 2022–23 income year to stop using the ram for breeding. At this time, as Aisha uses the herd scheme to value all sheep classes, the ram (if retained) would be valued at $372, the herd scheme value for breeding rams for the 2022–23 income year.

65 Section EC 34(1).
66 Average market values of specified livestock – 1997 *Tax Information Bulletin* Vol 9, No 6 (June 1997): at 2.
67 Section EC 32(2).
68 Section 14C of the Tax Administration Act 1994.
69 Section EC 32(3).
70 Section EC 35(1).
71 Section EC 35(2).
72 Section EC 35(3) and (4).

Other valuation methods – cost price, market value or replacement price

Cost price method

72. As discussed at [19], in its final report, the Consultative Committee on Primary Sector Taxation described the cost options that should be available to value livestock. As a result of that and later advice from the committee, the cost price and NSC methods were implemented. Both methods seek to determine the costs of production to bring livestock to a mature state.

73. The cost method works similarly to the NSC method, except that rather than the Commissioner determining the costs of production at a national level, a farmer uses their self-assessed costs of production to determine costs at a farm level.

74. The guidelines for calculating a self-assessed cost for specified livestock were developed for introduction in the 1991–92 income year. These guidelines are complex and rely on the farmer having an inventory system capable of tracking individual livestock units over their life on the farm.

75. Calculating the production costs of specified livestock (other than pigs, for which different steps apply) involves six main steps:
    - **Step 1** – Identify and specify the direct costs of livestock production and assign identifiable costs to each livestock type.
    - **Step 2** – Calculate the total farm livestock units.
    - **Step 3** – Apportion the undivided direct costs of livestock production between the livestock types. Do this based on the proportion of total farm livestock units associated with each type and class of livestock.
    - **Step 4** – Use dual product multipliers to allocate some of the costs to the production of meat, wool, fibre, milk or velvet, as appropriate.
    - **Step 5** – Include the costs of livestock purchased.
    - **Step 6** – Calculate an average cost per head and use it to value that year's intake of stock in each age group on hand at the end of the income year. Where mature livestock of mixed ages and intake years is valued at cost, you will need an inventory system to account for livestock over their lifetime on the farm.

76. For more information on calculating costs for specified livestock, see **Appendix A: Livestock production – establishing a self-assessed cost**.[73]

77. If a taxpayer uses the self-assessed cost method, they should take care to establish sufficient documentation to support the values used.

78. The Commissioner recommends that a taxpayer seeks professional advice before endeavouring to use this method.

Market value and replacement price methods

79. The valuation options of market value and replacement price are sufficiently similar to discuss together.

80. The concept of market value appears throughout the Act. It is regarded as the current selling value in the relevant selling market of the taxpayer's business.[74]

81. Replacement price is the market value of the livestock at balance date or, if there is no market value at that date, the last price the taxpayer paid during the income year to acquire equivalent livestock. In establishing replacement price, any amount of GST input tax is disregarded.[75]

82. Although it is not a legislative requirement to obtain an independent market valuation to support the values used, a taxpayer using market value or replacement price must be able to substantiate the value used if the Commissioner requires them to. In view of this, many taxpayers find obtaining a valuation from a recognised livestock valuer the easiest (and most accurate) way of supporting the valuations they have used. Any valuation must be accurate as at a taxpayer's balance date.

73 Appendix A: Livestock production – establishing a self-assessed cost *Tax Information Bulletin* Vol 4, No 7 (March 1993): 2.

74 *Australasian Jam Co Pty Ltd v FCT* [1953] HCA 52.

75 Section EB 10.

Non-specified livestock

Meaning of "non-specified livestock"

83. The term "non-specified livestock" means livestock other than bloodstock, high-priced livestock and specified livestock.[76]

84. For the purposes of this statement, "livestock" means **all live animals the breeding of which is regulated by humans and are held as assets of a business**. This being so, the term non-specified livestock could include any type of livestock other than bloodstock, high-priced livestock and specified livestock. It could include, for instance, such diverse animals as chickens, emus, ostriches, rabbits, alpacas, farmed fish and shellfish.

85. While these types of animals **could be** non-specified livestock, they **will be** non-specified livestock, and subject to the valuation requirements set out in subpart EC, if they are farmed as part of a farming business (as discussed from [5]).

Valuation methods

86. The owners of non-specified livestock can choose to value that livestock using:[77]
    - the (self-assessed) cost price method;
    - the market value method;
    - the replacement price method; or
    - if the Commissioner agrees, a standard value.

87. A taxpayer may move freely between these options without providing written notice to the Commissioner. For instance, they could choose to value their non-specified livestock using the cost price method one year, and then the next year choose to value that stock using the market value method.

88. While the legislation provides for a standard value as a legitimate valuation option, this option is available only if the Commissioner agrees to such a value. The Commissioner has not approved any standard values.[78]

Cost price method (self-assessed)

89. As it relates to specified livestock, the cost price method was discussed from [72]. The matters covered apply equally to non-specified livestock, except that the Commissioner has not published generic guidelines for calculating a self-assessed cost for all non-specified livestock.

90. The only published guidelines that involve non-specified livestock are contained in **Ostriches and emus – valuation for income tax purposes**.[79] These guidelines are based on those developed for specified livestock, with variations to account for the unique nature of farming birds, such as a methodology for valuing the bird's eggs at the end of the year.[80]

91. These guidelines, and the guidelines developed for specified livestock, may be of use to owners of non-specified livestock (depending on the type of livestock they are valuing). However, it is important that any methodology taxpayers develop to value their livestock is based on accurate, verifiable data that realistically captures the costs of production for that livestock type.

Market value and replacement price methods

92. As they relate to specified livestock, the market value and replacement price valuation methods were discussed from [79]. The matters covered apply equally to non-specified livestock.

76 Section YA 1.

77 Section EC 30.

78 As required by s EC 29.

79 Ostriches and emus – valuation for income tax purposes *Tax Information Bulletin* Vol 9, No 8 (August 1997): 11.

80 Although as previously mentioned in this statement, eggs are not *livestock* and therefore not subject to the requirement to be valued as livestock, they may need to be valued as ordinary trading stock if they are produced for sale.

Bloodstock

93. For the purposes of the livestock valuation rules, "bloodstock" means a horse that is a member of the standardbred or thoroughbred breed of horses. It also includes a share or interest in such a horse.[81]

94. At the end of each year, bloodstock that is used or intended to be used for breeding must be valued at its cost price. From maturity, that cost price must be reduced by an amount that varies based on whether the bloodstock is a stallion or mare and whether a previous owner has used the horse for breeding.[82]

95. Even where the actual cost cannot be calculated (with certainty), such as with home-bred progeny, a bloodstock breeder must still establish the cost price of that progeny. For guidance on how to calculate that cost price, see **QB 21/09**.[83]

Other matters

Transfers of livestock between a wholly owned group of companies

96. Livestock transferred between members of a wholly owned group of companies during the income year may be valued at year end at the cost of that livestock to the company that originally owned it. This can occur when:
    - the group members that have owned the livestock are all resident in New Zealand;
    - both the company that owned the livestock at the beginning of the income year and the company owning the livestock at the end of that year are still members of the group at the end of the income year; and
    - both companies share the same balance date or, if they do not, the Commissioner has approved their adoption of different balance dates because those dates correspond to the end of a business cycle and are necessary to avoid material distortions in net income.

97. If the companies stop being part of the same wholly owned group, then the company that owns the livestock at the end of the income year is treated as disposing of and reacquiring the livestock for its market value at the time the group membership ends. If the market value of the livestock cannot be determined separately from other property, the market value of the livestock at the time that company acquired it is treated as its value.

Bailed livestock

98. A bailment of livestock occurs when the owner of livestock (the bailor) bails or leases that livestock to another person (the bailee). There are two forms of bailment agreement.[84] A long-term bailment exists where the bailor does not expect the same livestock that are subject to the bailment agreement to be delivered back to them. This contrasts with a short-term bailment, where the bailor expects to have the same livestock returned to them, and the bailee does not provide consideration for the delivery of the livestock, and the bailment ends no later than the end of the income year after the income year that the bailment agreement was made.

99. Most New Zealand bailments meet the definition of a short-term bailment. Where this is the case, then, while the bailor accounts for this livestock in the ordinary way, the bailee can "back out" the bailed livestock from their accounts. They do this by calculating the number of total livestock in a class (the number they own plus the number of bailed livestock in that class) and deducting from that total the number of bailed livestock in that class. They then value the number left. This is illustrated in Example 7

100. Where the bailment is a long-term bailment both the bailor and bailee must account for the bailed livestock at year end; the bailor as owner and the bailee because they have an interest in the livestock. The bailor must value the bailed livestock using the herd scheme. The NSC and the cost price valuation methods are not available to a bailor where the livestock are being bailed under a long-term bailment arrangement.

81 Section YA 1.

82 Sections EC 39, EC 41, EC 42, EZ 5 and EZ 6.

83 QB 21/09: How to determine the cost price of bloodstock *Tax Information Bulletin* Vol 33, No 9 (October 2021): 42.

84 Section EC 27.

Example 7: Bailee's treatment of livestock that are subject to a short-term bailment

Livestock class on hand	Total livestock (owned and bailed)	Bailed livestock	Number to be valued for tax purposes
Rising 1-year hinds	220	100	120
Rising 2-year hinds	180	180	0
Mixed aged hinds	310	175	135
Rising 1-year stags	25	0	25
Breeding stags	2	0	2
Total	**737**	**455**	**282**

Livestock gifted because of an adverse event

101. Sometimes, where a farmer has lost stock because of an adverse event, they may receive replacement livestock from other farmers. Often the other farmers give this livestock for consideration that is less than market value or may even donate it for no consideration. Where either of these situations occurs and the recipient and supplier are not associated, both parties treat the acquisition and disposal of the livestock as being disposed of and acquired at the greater of nil or the actual consideration paid.[85]

102. Where the parties are associated, then both parties to the transaction are required to treat the transaction as having occurred at the market value of the livestock transferred.[86]

Joint interests – partnerships, joint ownership and look-through companies

Jointly owned livestock requires joint election of valuation method

103. For any election to be effective, where livestock is owned by two or more persons all owners must jointly elect the valuation method to be used.[87]

104. Where no effective election is made, then:
    - where the owners bail or lease livestock, or enter a profit-sharing arrangement, the market value method applies; and
    - in any other case, the NSC scheme applies.[88]

105. Where owners have a profit-sharing arrangement and livestock under the arrangement is valued using the cost price or NSC method, all parties to the arrangement are treated as the single owner of the livestock.[89]

106. Where a taxpayer has an interest in livestock in a partnership or a look-through company, they must treat these interests separately to any other livestock interests they have. While separate elections are required for the different interests, the taxpayer does not have to choose the same valuation method for each interest.[90]

85 Section EC 5.
86 Section GC 1.
87 Section EC 12(1).
88 Section EC 12(2).
89 Section EC 12(3).
90 Section EC 12(4) and (5).

Changes in partnership interests

107. Where partnership interests change (so a new partnership is created) and more than 50% of the property is the same between the two partnerships, the new partnership must value specified livestock in the same manner as the old partnership.[91] A change in partnership interests can occur not only when a partner leaves or joins a partnership but also when a partner retires or dies.

108. Special rules apply when a new partner enters a partnership and acquires an interest in specified livestock (that include female breeding stock) that the partnership has valued using the cost price or NSC method.[92]

109. Where this occurs, in the partnership accounts the new partner is treated as using the same cost base as the exiting partner;[93] the partnerships livestock cost base does not alter to account for the acquisition cost the new partner may have paid, and the partnership carries on as though nothing has happened (other than the change in partner).

110. The exiting partner accounts for any profit made on the sale of livestock in the tax year in which that profit is derived.

111. The new partner may claim the cost of acquiring the livestock as a deduction. However, they must also calculate a new cost base for the acquired livestock.

112. In the year of acquisition, the value of this new cost base will be that livestock's existing cost base (as shown in the partnership's accounts) plus, an amount calculated using the formula in [113]. It must be a positive amount. In the following years, this cost base amount is progressively reduced so as to provide an amount of amortisation that the new partner may claim as a deduction.

113. The yearly amounts to be added to the existing cost base are based on the formula:

$$\text{livestock cost base difference} \times \text{current year count} \div \text{allowed years}$$ [94]

Where:[95]

Livestock cost base difference equals the price the new partner paid to acquire the exiting partner's share of partnership livestock, less the existing cost base for that livestock in the year of acquisition.

The **allowed years** are five, unless, before the end of the income year in which the livestock was acquired, the partnership acquires or disposes of any further partnership interests (that include livestock). If this occurs, the allowed years are four.

Where the allowed years are five, the **current year count** equals five in the year of acquisition, four in the following year, three in the next and so on.

This is illustrated in Example 8.

91 Section EC 13.

92 Section EC 26B(1).

93 Section EC 26B(2).

94 Section EC 26B(3).

95 Section EC 26B(4).

Example 8: Calculating the spread available to a new partner

To calculate the amount available to be spread to future years by a new partner, the following information is relevant.

- The new partner paid $750,000 to acquire the exiting partner's share of partnership livestock during the 2018 tax year. The exiting partner's cost base for that livestock was $310,000. Therefore, the livestock cost base difference is $440,000.
- As the partnership did not acquire or dispose of any further partnership interests in the year of acquisition, the allowed years is five.

Using the formula **livestock cost base difference × current year count ÷ allowed years** the amount to be added to the livestock's existing cost base in each year is as follows:

Tax year	Calculation	$
2018	($440,000 x 5 ÷ 5)	440,000
2019	($440,000 x 4 ÷ 5)	352,000
2020	($440,000 x 3 ÷ 5)	264,000
2021	($440,000 x 2 ÷ 5)	176,000
2022	($440,000 x 1 ÷ 5)	88,000

The effect of this calculation in the new partner's income tax return in 2018 and 2019 years is as follows:

2018	$		$
Purchases	750,00	Existing cost base	310,000
		Formula amount	440,000
		Closing stock (new cost base)	**750,000**
	750,000		**750,000**

The income effect for the 2018 year is $0.

2019	$		$
Opening stock	750,000	Existing cost base	310,000
		Formula amount	352,000
		Closing stock (new cost base)	**662,000**
		Amortisation amount	88,000
	750,000		**750,000**

The income effect for the 2019 year is -$88,000.

114. As Example 8 shows, the amount to be amortised (the difference between the acquisition price and the existing cost base of that livestock – $440,000 in this example), is amortised on a straight-line basis over the five **allowed years**. In this example, the 2019 year amortisation of $88,000 is allowed as a deduction in each of the following allowed years. The formula does not allow an amortisation deduction in the year of acquisition.

Valuation of livestock on the death of the farmer

Executors and administrators are bound by the farmer's valuation elections

115. When a farmer dies and their estate is transferred to an executor or administrator, the estate (including any livestock) is deemed to have been disposed of by the farmer and acquired by the executor or administrator immediately before the farmer's death.[96]

116. Because executors and administrators effectively step into the shoes of the deceased as their personal representative, they are bound by any valuation elections the deceased made.

117. Exceptions to this approach apply where the property is transferred to the deceased's surviving spouse, civil union partner, de facto partner, a person who is within the second degree of relationship to the deceased person (ie their children) or a charity.[97] In these circumstances, the livestock is treated as a transfer of property on the settlement of relationship property as long as certain other legislative requirements are met.[98] These requirements are set out in s FC 4 (property transferred to charities or to close relatives and others), which is reproduced in the Appendix.

Where the deceased used the herd scheme to value specified livestock

118. Where the farmer had used the herd scheme to value a type or class of specified livestock, the herd scheme must continue to be used for that livestock when the:
    - will creates a life interest in the relevant livestock; or
    - livestock is transferred to the executor or administrator (because the executor or administrator "stands in the shoes" of the deceased).

This Statement was signed on 26 March 2025.

Stephen Donaldson

Technical Lead, Technical Standards, Legal Service

96 Section FC 2(1) and (2).

97 Sections FC 3 and FC 4.

98 Sections FC 3(1) and FC 4(1) and (3).

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Income Tax Amendment Act (No 2) 1993, s 20

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Appendix: Legislation

Income Tax Act 2007

A1. To determine the livestock required to be valued (discussed from [5]), s EC 1:[99]

> **EC 1 Application of this subpart**
>
> (1) This subpart applies to the valuation of livestock when -
>
> (a) a person who owns or carries on a farming business, other than a livestock dealing business, holds livestock for the purposes of farming that livestock in the ordinary course of carrying on the farming business:
>
> (b) a person who owns livestock bails that livestock to another person under a bailment, lease or other agreement.
>
> (2) Subsection (1) applies for the 2008–09 and later income years. However, subsection (1) does not apply to a person in relation to a tax position taken by the person—
>
> (a) in the period that starts on the first day of the 2008–09 income year and ends on 26 August 2024; and
>
> (b) relating to the valuation of livestock; and
>
> (c) that is inconsistent with the amendment made to section EC 1 by subsection (1).

A2. To calculate the number of livestock for which an alternative valuation option other than the herd scheme can be used (discussed from [42]), s EC 8(3) to (5) provides:

> **EC 8 Restrictions arising from use of herd scheme**
>
> …
>
> *Second exception: increase in a class*
>
> (3) Despite subsection (1), a valuation method other than the herd scheme is available to a person in an income year, to the extent of a person's animals of a class, in an income year (the **current year**), that are in excess of the person's class closing animal balance.
>
> *A definition and a formula*
>
> (4) **Class closing animal balance** means the number of animals of a class calculated using the formula—
>
> last year's class amount + associated class transfers.
>
> *Definition of items in formula*
>
> (5) In the formula,—
>
> (a) **last year's class amount** is the animals of the relevant class that the person valued under the herd scheme at the end of the year before the current year:
>
> (b) **associated class transfers** is the amount, if positive, calculated under section EC 4B(5), for the relevant class, that are transferred in the current year to the person to the extent to which section EC 4B(4) applies to the type of animals transferred.

99 As introduced by the Taxation (Annual Rates for 2024–25, Emergency Response, and Remedial Measures) Bill 2024.

A3. To calculate the herd value ratio (discussed from [45]), s EC 17(5) to (7) provides:

> **EC 17 Herd value ratio**
>
> …
>
> *Calculation of herd value ratio*
>
> (5) The herd value ratio for livestock of a particular type is calculated by using the formula in subsection (6) and rounding the result of the calculation to the nearest of the following figures: 0.9, 1.0, 1.1, 1.2, 1.3.
>
> *Formula*
>
> (6) The formula is—
>
> $$\sum(\text{average value} \times \text{number}) \div \sum(\text{herd value} \times \text{number}).$$
>
> *Definition of items in formula*
>
> (7) In the formula,—
>
> (a) ∑ is the total of the individual calculations for all applicable classes of livestock type valued under the herd scheme:
>
> (b) **average value** is the average value of an animal in a class as described in subsection (4):
>
> (c) **number** is the number of all livestock of that class on hand at the end of the income year, including livestock that are not in the herd scheme, but not including high-priced livestock:
>
> (d) **herd value** is the herd value of livestock for a class.

A4. To calculate the partners' cost base (discussed from [107]), s EC 26B provides:

> **EC 26B Entering partners' cost base**
>
> *When this section applies*
>
> (1) This section applies when an entering partner has acquired specified livestock that includes female breeding livestock for which section HG 10 (Disposal of livestock) applies, and the partners use the cost price method or the national standard cost scheme.
>
> *Existing cost base*
>
> (2) For the specified livestock, the entering partner is treated as having the same existing cost base that the exiting partner would have had for the purposes of the cost price method or national standard cost scheme for an income year, if they had not disposed of the interests.
>
> *Addition to cost base*
>
> (3) For the purposes of determining the value of the specified livestock at the end of an income year for the purposes of section EC 2, the entering partner must add to the existing cost base, described in subsection (2), the amount for the income year (the **current year**) calculated using the following formula:
>
> $$\text{livestock cost base difference} \times \text{current year count} \div \text{allowed years}.$$
>
> *Definition of items in formula*
>
> (4) In the formula,—
>
> (a) **livestock cost base difference** is the cost base that the entering partner would have for the specified livestock at the end of the income year in which the acquisition of the specified livestock occurred, ignoring subsection (2) reduced by the entering partner's existing cost base for the specified livestock at the end of that year, described in subsection (2). It must be a positive number:
>
> (b) **current year count**,—
>
> (i) is the allowed years reduced by the number of years between the current year and the income year in which the entering partner's acquisition of the specified livestock occurred, ignoring years in which the partners do not use the cost price method or national standard cost scheme (for example: **current year count** is **1**, if the allowed years is **4**, and the acquisition of the specified livestock occurred in the 2010–11 income year, and the current year is the 2013–14 income year, and the relevant method or scheme was used for all relevant income years):
>
> (ii) may equal the allowed years (for example: the current year is the same year as the income year in which the entering partner's acquisition of the specified livestock occurred), but must not be a negative number:

(c) **allowed years** is—

(i) 4, if the partners acquire or dispose of any partnership interests that include any livestock after the entering partner's acquisition of the specified livestock and before the end of the income year in which that acquisition occurred; or

(ii) 5, if the partners do not acquire or dispose of any partnership interests that include any livestock after the entering partner's acquisition of the specified livestock and before the end of the income year in which that acquisition occurred.

A5. For the transfer of property upon death, s FC 4 (discussed from [115]) provides:

FC 4 Property transferred to charities or to close relatives and others

When this section applies

(1) This section applies in the circumstances described in section FC 1(1)(b) when tax-base property is transferred on a person's death if—

(a) each beneficiary of the deceased person is described in subsection (2); and

(b) no life interest in the property is created; and

(c) no trust over the property is created, other than a trust to execute the will and administer the estate; and

(d) the net income of the estate is distributed as described in subsection (3).

Beneficiaries of deceased

(2) A beneficiary of the deceased person must be—

(a) a close relative of the deceased person:

(b) a person exempt under section CW 41, CW 42, or CW 43 (which relate to exempt income of charities).

Income from estate must be distributed

(3) While the administration of the estate is continuing, the net income of the estate is distributed to the extent allowed—

(a) under the will or the rules governing intestacy; and

(b) by the trustee's legal obligations.

Transfer subject to subpart FB

(4) The transfer is treated as a transfer of property on a settlement of relationship property under subpart FB (Transfers of relationship).

OP 25/01: Commissioner's operational position on the GST treatment of fees paid in relation to managed funds

IS 25/05 sets out the Commissioner's view on the GST treatment of fees received by a manager of a managed fund and fees received by third-party suppliers (including investment managers) for supplies made to the manager of a managed fund. This interpretation statement was issued on 31 March 2025.

The Commissioner recognises that immediate implementation of the position outlined in this interpretation statement could be difficult for some taxpayers, due to required changes to, for example, computer systems and/or contractual arrangements.

Therefore, the Commissioner will not be devoting resources to determining whether a taxpayer has applied the interpretation statement in GST periods that cover 1 April 2025 to 31 March 2026.

However, the Commissioner expects taxpayers to have adopted the position outlined in IS 25/05 by 1 April 2026.

INTERPRETATION STATEMENTS

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

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

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

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 25/05: GST treatment of fees paid in relation to managed funds

Issued | Tukuna: 31 March 2025

This interpretation statement considers the GST treatment of fees received by a manager of a managed fund and fees received by third-party suppliers (including investment managers) for supplies made to the manager of a managed fund.

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

Summary | Whakarāpopoto

1. Managed investment funds are an important element of the savings of New Zealanders. Money is pooled and managed by a fund manager, and a fund supervisor scrutinises the manager's performance. The fund supervisor or a custodian holds the funds invested. Investment decisions are made by the fund manager or outsourced to an investment manager. The administration of certain aspects of the fund may also be outsourced.
2. From a GST perspective, the various relationships between the parties and the fund gives rise to interpretive issues, in particular relating to the application or non-application of the section 14(1)(a) exemption for supplies of financial services.
3. This interpretation statement addresses three key issues concerning the GST treatment of managed funds; namely, the GST treatment of:
   - fees payable by investors/the fund to the manager of a managed fund for the various services the manager supplies to the investors/the fund;
   - outsourced administrative services a third party provides to the manager of a managed fund (including services such as registry services, fund accounting, the management of financial transactions between a member and the scheme, and the management of portfolio investment entity (PIE) tax obligations); and
   - outsourced investment management services a third party provides under a contract with the manager of a managed fund.
4. This interpretation statement concludes the following.

   Fees payable to the manager of a managed fund

   - The fees payable to the manager of a managed fund for services supplied to the investors/the fund (or the supervisor on the investors' behalf) are not subject to GST as they are consideration for exempt supplies of financial services under section 14(1)(a). The supply or supplies made by the manager are exempt from GST as:
     - each activity the manager carries on is one of the activities listed in the definition of "financial services" (section 3); or
     - some of the activities the manager carries on are listed in the definition of "financial services" and any other services the manager supplies are reasonably incidental and necessary to the financial services the manager is supplying.

GST treatment of outsourced services in relation to a managed fund

- The outsourced supply of administrative services (including registry services, fund accounting and unit pricing) by a third party under a contract with the manager of the managed fund is a taxable supply. Administrative services are not exempt supplies of financial services because they are not one of the activities listed in section 3(1) and, generally, are not reasonably incidental and necessary to a supply of financial services.
- The supply of investment management services carried out by a third-party investment manager is either an exempt supply of financial services or a taxable supply of advice, depending on the terms of the investment manager's appointment and the manner in which this appointment is exercised and supervised.
- Where a third-party investment manager has authority to make and implement investment decisions, the investment manager makes an exempt supply of financial services because they arrange the transfer of securities (section 3(1)(l)).
- Where a third-party investment manager's investment recommendations are subject to a high level of oversight and scrutiny and a manager can veto the recommendations on the merits, the investment manager does not have authority to implement the recommendations, so such an investment manager provides investment advice, which is a taxable supply.
- However, where a manager has the right to veto an investment decision made by a third-party investment manager, the service may still be an exempt supply of arranging financial services. This would be the case where a third-party investment manager has authority to give instructions to a supervisor for the acquisition or sale of securities, and a manager's discretion to veto transactions is limited to checking that investment decisions made by the investment manager comply with the mandate. In this situation, the investment manager arranges financial services under section 3(1)(l).
- For arrangements where the manager and supervisor of the managed fund have a wider legal power to override the investment decisions of an investment manager, a court is likely to consider evidence of how an investment manager's contract is given effect to in practice. Evidence that investment decisions of an investment manager are not closely scrutinised by the manager, and transactions are largely made without any intervention by the manager or supervisor, would support a finding that the investment manager is supplying an arranging service (which would be an exempt supply).

Introduction | Whakataki

5. A "managed investment scheme" (defined in section 9 of the Financial Markets Conduct Act 2013 (FMCA)), which is generally established by a trust deed, pools money from multiple investors and then invests the pooled money according to the particular investment strategies of each managed fund (or investment fund) under the scheme. In other words, a scheme may have multiple funds. Among other classifications, a fund can be a wholesale fund, catering to wholesale investors and retail funds, or a retail fund, catering to retail investors.
6. The investors rely on the expertise of the scheme's manager (or an outsourced third-party investment manager) and the economies of scale created by pooling funds to create a larger investment.
7. The specific funds under the scheme can be created by the manager with the consent of the scheme's supervisor to segregate investor money into separate investing strategies. A fund's assets and liabilities are legally and practically separated from those of other funds under the scheme. The specific method of separation depends on the terms of the relevant trust deed.
8. The next part of this item discusses the roles and functions of the main participants in the managed funds area. It is worth briefly summarising the arrangement involved in a managed fund.

Key features of a managed fund

9. The main participants are as follows:
   - The **investors** invest their money into a scheme or fund.
   - The **supervisor or trustee** holds the fund's assets, represents the investors' interests and monitors the fund manager's performance. The supervisor may contract out the holding of the fund's property to a separate custodian. When a managed investment scheme is to be registered (section 127 of the FMCA), it must have a licensed supervisor before registration can take place.

- The **manager** manages the funds on the investors' behalf. This management includes administering both the fund and the fund's investment activities. The performance of either or both functions may be contracted out to a third party.

10. The managed fund is primarily regulated by the FMCA. The main documents relevant for a fund are the governing document (generally a trust deed), product disclosure statement (PDS), and statement of investment policy and objectives (SIPO).

11. The functions of the supervisor (or trustee),[1] for a retail scheme and any fund under the scheme, include:[2]
    - acting on investors' behalf in relation to the manager, the governing document, the terms of any offer, and any contravention of issuer obligations or applicable laws;
    - supervising the manager's performance in respect of their functions and compliance with their issuer obligations; and
    - holding the scheme property or ensuring the property is held by a custodian[3] by entering into an agreement for the supply of custodial services with a third-party custodian.

12. The manager is responsible for the management and administration of the scheme, including any fund under the scheme.[4] The manager's functions include:[5]
    - managing the scheme property and investments, including receiving and distributing income from investments, making investment decisions, and exercising any voting rights attached to securities the scheme holds (in accordance with the SIPO and/or investment mandate for the scheme);
    - offering, issuing and redeeming the units in the scheme; and
    - administering the scheme (for example, maintaining a register of unitholders, record-keeping and reporting, and tax and regulatory compliance).

13. The manager may contract with third parties to provide some or all of its management and administration functions.[6] For example, the manager may engage third parties to provide:[7]
    - registry services, including records of unitholder details and details of their holdings in the scheme;
    - accounting services, including unit pricing and calculating the value of member interests;
    - the management of financial transactions between members and the scheme, and the management of PIE tax obligations; and
    - investment management or advisory services (that is, the management of the fund's investments or advising on what those investments should be).

14. If the manager engages a third party to provide investment management or advisory services, the nature of the services provided could take several forms. For example, a third party could be engaged to:
    - provide only investment advisory services, meaning they advise on what investment decisions they think should be made regarding the investment portfolio, and the manager is then free to determine whether and to what extent to act on the advice; or
    - manage some or all of the portfolio with autonomy to make investment decisions and to give instructions to brokers to give effect to those decisions (subject to the requirements of the SIPO or investment mandate for the scheme and/or funds).

1 If the scheme is established under a trust deed, the supervisor is the trustee of the trust (section 153(4) of the FMCA). This statement does not cover the GST treatment of the supervisor/trustee.

2 Section 152 of the FMCA.

3 This statement does not cover the GST treatment of a custodian.

4 The scheme and the manager are separate persons for GST purposes.

5 Section 142 of the FMCA.

6 Section 146 of the FMCA. If the manager contracts out the performance of any of its functions, that does not affect the liability of the manager for the performance of those functions (section 146(2)(b)).

7 Where custodial services are contracted out, it is the supervisor rather than the manager who contracts with the custodian. The supervisor can also engage an expert (for example, an auditor, investigating accountant, valuer or actuary) if required to determine the financial position or review the business, operation, management systems, or governance of the manager or the scheme (section 155 of the FMCA).

15. A manager may decide to invest all or part of the scheme property in a wholesale scheme that has its own manager. This is not, in legal terms, engaging a third party to provide investment management services, and the units in the wholesale scheme are treated like any other security the scheme holds. However, in commercial terms such an arrangement may have the same effect as engaging a third party to manage investments.
16. When the manager makes investment decisions to buy or sell securities for the scheme (including for any particular fund), the manager gives instructions to:[8]
    - the supervisor or custodian to place the buy or sell orders with a broker and to settle the transaction; or
    - a broker to place the buy or sell orders and instructs the supervisor or custodian to settle the transaction.
17. To settle the transaction, the supervisor or custodian must, for a sale, arrange the transfer of the securities to the purchaser and receive the sale price and must, for a purchase, provide the funds to the vendor and take ownership of the securities.
18. The manager's investment decisions and/or execution of instructions must also comply with the requirements of the SIPO and investment mandates for the scheme and/or funds.
19. When the manager has engaged a third-party investment manager with authority to make and implement investment decisions, that third party:
    - gives instructions to a broker to place the buy or sell orders; and
    - instructs the supervisor or custodian to settle the transaction.
20. For a third-party investment manager (as when the manager undertakes such activity), the investment decisions and/or execution of instructions must also comply with the requirements of the SIPO and investment mandates for the scheme and/or funds.
21. In certain circumstances, the manager or supervisor may refuse to allow a transaction initiated by a third-party investment manager to proceed, even after the third party has given instructions to a broker. In the case of the supervisor, that right of refusal is limited to the circumstances referred to in section 160(1) of the FMCA.[9] In the case of the manager, the circumstances may be broader and may depend on the nature of the arrangement with the third-party investment manager.
22. The governing document (generally the trust deed) must provide for the fees and expenses that can be paid out of scheme property to any manager, third-party investment manager or administration manager, supervisor or custodian and the basis on which those fees and expenses are to be determined.[10] Nevertheless, in general (and noting that such fees and expenses may be paid out of particular funds to the extent applicable), the following is the case:
    - The manager is generally entitled to charge a management fee for the services they perform, which is paid out of scheme property. This is typically calculated by reference to the value of the scheme, which is referred to in the industry as the funds under management. There may also be a performance component to the manager's fee. Some schemes also provide for a transaction fee to be payable to the manager on the subscription or redemption of units. In addition, schemes may allow for an administration or membership fee to be charged to investors.
    - The manager may be entitled to be reimbursed out of scheme property for expenses incurred in the performance of their functions. The supervisor may likewise be entitled to be reimbursed.
    - The supervisor is paid a fee for their role as supervisor of the scheme. Depending on the terms of the governing document, this fee could be paid directly out of scheme property or by the manager, who may or may not be entitled to reimbursement for these expenses.
    - Where the manager contracts with a third party to provide some or all of its management and administration functions, the manager agrees to pay a fee to the third party for those services. If the manager is entitled to be reimbursed out of scheme property for these fees, the manager may arrange for the third parties to be paid directly from the scheme by way of payment direction rather than the manager paying the third party and then getting reimbursed from the scheme.

8 The manager's powers in this regard may be subject to the provisions of the trust deed or other governing document or to any separate agreement(s) between the supervisor and the manager.

9 Namely, if the supervisor considers that the proposed acquisition or disposal would be in breach of the scheme's governing document, any rule of law or any enactment or manifestly not in the interests of scheme participants.

10 Section 135(f) of the FMCA.

- Where the supervisor contracts with a third-party custodian to provide custodial services, the supervisor agrees to pay a fee for those services. If the supervisor is entitled to be reimbursed out of scheme property for these fees, the supervisor may arrange for the third party to be paid directly from the scheme by way of payment direction rather than the supervisor paying the third-party custodian and then getting reimbursed from the scheme.

23. This interpretation statement applies to managed funds that invest in debt, equity, and participatory securities. It does not apply to investment funds where the manager of the fund directly holds real property such as commercial property or infrastructure assets. It also does not apply to venture capital funds where the manager of the venture capital fund is able to influence the management of the business of the entity it holds a stake in (which is covered by section 3(1)(m)).

Analysis | Tātari

24. Bearing in mind the statutory and factual context discussed above, this interpretation statement now considers how the GST legislation applies in relation to the three issues described at [3].

Issue one | Take tuatahi - GST treatment of fees payable to manager of a managed fund

25. Determining the GST treatment of fees paid to a managed fund manager requires consideration of the legal arrangements entered into by the parties. (See *CIR v NZ Refining Company Ltd* (1997) 18 NZTC 13,187 (CA), *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075 (CA), and *CIR v Gulf Harbour Development Ltd* (2004) 21 NZTC 18,915 (CA).)

26. The terms of the agreement between the manager and investors are in the governing document (generally a trust deed) and the PDS. As a trust deed for a managed fund has no effect if it contravenes or is inconsistent with the FMCA, the manager's obligations under a trust deed must be consistent with the manager's statutory obligations under the FMCA (section 138).

27. The manager's responsibilities were discussed at [12]. These responsibilities include:[11]
   - managing the scheme property and investments, including receiving and distributing income from investments, making investment decisions, and exercising any voting rights attached to securities held by the scheme (in accordance with the SIPO and/or investment mandate for the scheme);
   - offering, issuing and redeeming the units in the scheme; and
   - administering the scheme (for example, maintaining a register of unitholders, record-keeping and reporting, and tax and regulatory compliance).

28. The manager does not supply marketing and advertising services, compliance services or tax advice. Investors do not contract for the supply of these services. The manager carries out marketing and advertising for the purpose of promoting and enabling the issue of units to investors, but it does not supply those services to anyone, they are internal activities that support their actual supplies. The manager complies with their obligations under the FMCA to enable them to issue or transfer units and to continue to act as the manager of a managed fund.

Supplies of financial services are exempt supplies

29. Section 14(1)(a) exempts the supply of financial services, stating:

> **14 Exempt supplies**
>
> (1) The following supplies of goods and services shall be exempt from tax:
>
> (a) the supply of any financial services (together with the supply of any other goods and services, supplied by the supplier of those financial services, which are reasonably incidental and necessary to that supply of financial services), not being a supply referred to in subsection (1B):

30. As set out in section 14(1)(a), the supply of "other goods and services" is also an exempt supply if the:
   - other goods and services are supplied by the supplier of financial services together with the supply of the financial services; and
   - supply of the other goods and services is "reasonably incidental and necessary" to the supply of those financial services.

11 Section 142 of the FMCA.

31. A "financial service" is any one or more of the activities listed in the definition in section 3(1). The relevant paragraphs of that definition for the purposes of this interpretation statement are as follows:

> **3 Meaning of term financial services**
>
> (1) For the purposes of this Act, the term **financial services** means any 1 or more of the following activities:
>
> …
>
> (c) the issue, allotment, drawing, acceptance, endorsement, or transfer of ownership of a debt security:
>
> (d) the issue, allotment, or transfer of ownership of an equity security or a participatory security:
>
> …
>
> (ka) the payment or collection of any amount of interest, principal, dividend, or other amount whatever in respect of any debt security, equity security, participatory security, credit contract, contract of life insurance, retirement scheme, financial option, or futures contract:
>
> (l) agreeing to do, or arranging, any of the activities specified in paragraphs (a) to (ka), other than advising thereon:
>
> …

Issue and redemption of units

32. The issue, allotment or transfer of ownership of a participatory security is a financial service (section 3(1)(d)). "Participatory security" is defined in section 3(2) as follows:

> **participatory security** means any interest or right to participate in any capital, assets, earnings, or other property of any person where that interest or right forms part of a contributory scheme; and includes an interest in a unit trust (within the meaning of section YA 1 of the Income Tax Act 2007); but does not include an equity security, a debt security, money, or a cheque

33. "Contributory scheme" is also defined in section 3(2) as follows:

> **contributory scheme**—
>
> (a) means any scheme or arrangement that, in substance and irrespective of the form of the scheme or arrangement, involves the investment of money where—
>
> (i) the investor acquires or may acquire an interest in or right in respect of property; and
>
> (ii) that interest or right will or may be, under the terms of investment, used or exercised in conjunction with any other interest in or right in respect of property acquired in similar circumstances, whether at the same time or not; but
>
> (b) does not include a scheme or arrangement described in paragraph (a) that has 5 or fewer investors, provided that neither the manager of the scheme nor any associated person of the manager is the manager of another such scheme or arrangement

34. An interest in a unit trust (as defined in section YA 1 of the Income Tax Act 2007[12]) is also included in the definition of participatory security (section 3(2)).
35. An interest in a managed fund would satisfy the definition of "participatory security". Therefore, fees payable to the manager for the issue, redemption or repurchase of interests in a managed fund are not subject to GST as the fees are consideration for a financial service under section 3(1)(d). As such they are consideration for an exempt supply.

Payments in respect of units and securities

36. The payment or collection of any amount in respect of a debt security, equity security or participatory security (or arranging the payment or collection of such amounts) is a financial service (section 3(1)(ka) and (l)).
37. A managed fund may invest in debt securities, equity securities or participatory securities, including investing in another managed fund. The manager collects and distributes amounts in respect of securities (or arranges these activities). These activities are financial services under section 3(1)(ka) and (l).
38. Therefore, the fees relating to these activities are not subject to GST as they are consideration for an exempt supply.

Investment activities of the manager

39. Arranging the transfer of debt securities, equity securities or participatory securities is a financial service, but advising on the transfer of such securities is not a financial service (section 3(1)(c), (d) and (l)).
40. The manager is responsible for investing the fund's property in accordance with the SIPO and investment mandate and objectives specified in the trust deed or agreed with the trustee. The manager has discretion (subject to the SIPO and investment mandate) to make and implement decisions on what, and when, securities should be bought or sold with investor funds.

Manager does not provide advice

41. The manager does not provide advice on the transfer of securities. To advise means to recommend or inform, counsel or give an opinion (*Concise Oxford Dictionary* (12th ed, Oxford University Press, 2011), and *J R Moodie Co Ltd v MNR* [1950] 2 DLR 145 at 148 (SCC)). The manager does not give recommendations, counsel, or opinions on securities transactions. The manager has discretion, subject to the fund's investment policy and objectives, to make and implement investment decisions. The supervisor, who represents investors, must comply with the manager's instructions to buy or sell securities unless a transaction would be in breach of the scheme's governing document, any rule of law, or any enactment, or is manifestly not in the interests of the scheme participants (section 160 of the FMCA).

Manager's investment activities constitute an arranging service

42. "Arrange" means "cause to occur", "plan or provide for" or "give instructions for" (*Databank Systems Ltd v CIR* (1987) 9 NZTC 6,213 (HC), *Royal Bank of Canada v R* (2005) TCC 802, and *Canadian Medical Protective Assn v R* [2009] FCA 115). More than one person could be involved in arranging a financial service (*Canadian Medical Protective Assn*).

12 Section YA 1 of the Income Tax Act 2007 defines "unit trust" as follows:

unit trust—

(a) means a scheme or arrangement that is made for the purpose or has the effect of providing facilities for subscribers, purchasers, or contributors to participate, as beneficiaries under a trust, in income and capital gains arising from the property that is subject to the trust; and

(b) does not include—

(i) a trust for the benefit of debenture holders:

(ii) the Common Fund of Public Trust:

(iii) a group investment fund established by Public Trust:

(iv) the Common Fund of the Maori Trustee:

(v) a group investment fund established under the Trustee Companies Act 1967:

(vi) a friendly society registered under the Friendly Societies and Credit Unions Act 1982:

(vii) a superannuation fund:

(viii) an exempt ESS:

(ix) a fund that meets the requirements of section CW 45 (funeral trusts):

(x) any other trust of any specified kind that is declared not to be a unit trust for the purposes of section HD 13 (unit trusts) by the Governor-General by Order in Council (and such an order is secondary legislation (see Part 3 of the Legislation Act 2019 for publication requirements).

43. The manager carries out research and market analysis for the purpose of making investment decisions. Considered in isolation, research and market analysis are not financial services. However, the arranging of a supply of financial services could include activities that considered in isolation are not financial services. If a sufficient causal link exists between the research and market analysis activities and the transfer of securities, the research and market analysis is part of an arranging service.

44. To determine whether services constitute the arranging of financial services it is necessary to consider whether a sufficient relationship exists between the services and the supply of financial services. To be the arranging of the transfer of securities, a sufficient relationship must exist between the manager's activities and the transfer of securities.

45. Two Canadian cases provide some assistance in applying the "arranging" test in an investment management context.[13] These cases are helpful both for the issue of whether a manager's investment activities are exempt supplies of financial services and for the issue of whether an outsourced investment manager's activities are exempt supplies of financial services (discussed from [84]).

46. In *General Motors of Canada Ltd v R*,[14] the investment managers issued buy and sell orders to brokers to complete financial transactions. The trustee reviewed each order and provided funds to the broker to do the deal.[15] The trustee was not obliged to complete the transaction,[16] and in addition the fund's administrator could veto investment decisions the investment manager made. Notably, the investment management agreement stated the investment managers are "to provide investment advice and other related services".[17] Campbell J held:[18]

> The evidence as a whole points conclusively to the fact that the Investment Managers, in reality, did not exercise exclusive authority over the investment choices, and did not possess access to the funds to permit the "arranging for" transfers of financial instruments. Given that no less than two additional parties, the Trustee and GMCL, could veto the execution of the buy/sell orders, and the fact that the Investment Managers did not have access to the funds, support my determination, on a balance of probabilities, that the Investment Managers did not possess the authority nor the means to "arrange for" the transfer of financial instruments for GMCL.

47. Campbell J held further that the "arranging for a service" aspect was confined to calling a broker to complete the trade.[19]

48. Clearly, Campbell J considered it was relevant that two parties could veto the execution of the buy and sell orders. This factor is relevant, but it is not on its own decisive. That factor needs to be taken into consideration with all other relevant factors to decide whether a sufficient relationship exists between the services and the supply of financial services.

49. In *Canadian Medical Protective Assn*, the third-party investment manager had an unfettered discretion to buy and sell a particular group of securities. The Federal Court of Appeal referred to dictionary meanings of "arranging for"; namely, "cause to occur", "give instructions", "make preparation for" and "plan".[20] The court found that the words "give instructions" and "make preparation for" are acceptable interpretations of the words "arranging for" and are as wide and elastic as one wishes them to be.[21]

13 These Canadian cases are useful in a New Zealand financial services context because the relevant parts of the definition of financial services considered in the cases are essentially the same as the definition in New Zealand's GST Act.

14 *General Motors of Canada Ltd v R* [2008] TCC 117 (Tax Court of Canada). Although *General Motors* (TCC) was upheld on appeal in *General Motors of Canada Ltd v R* [2009] FCA 114, the decision that the third-party investment manager did not supply an exempt financial service was not decided on appeal.

15 At [93].

16 At [98].

17 At [99].

18 At [99].

19 At [100].

20 At [60].

21 At [61].

50. The Court held the dominant character of the service supplied was the research and analysis aspect of the trade but considered as a whole the services the investment managers performed, including the final order to buy or sell or the decision to hold, could not be divided.[22] Further, the manager did not provide advice, since there was no one to provide advice to except themselves.[23] The Court went on to hold that the result of the fund manager's service was to "cause to occur a transfer of ownership … of a financial instrument".[24] As a result, the services provided were "arranging" and exempt.[25] Paragraphs 62 to 64 of the judgment are set out below:

> [62] On the one hand, there is the world of a difference between the services of the investment managers and those of a broker who generally accomplishes a more mechanical type of work. If I were to retain the dominant character of the investment managers' services, the research and analysis aspect of the trade would be the dominant character of the services they supply.
>
> [63] On the other hand, the research and analysis aspect of the trade will be purposeless if it does not end with a buy or sell order or a "hold" decision. The final order is an essential characteristic of the management of the funds by the investment manager. Otherwise, the investment manager does not manage at all.
>
> [64] I find that, considered as a whole, the services performed by investment managers cannot be divided. It is a mix. They do not provide advice, since there is no one to provide advice to except themselves. The end result of their services is to "cause to occur a transfer of ownership … of a financial instrument". They fall within paragraph 123 (1) (d) and (l) of the Act.

51. Although *Canadian Medical Protective Assn* is not binding on a New Zealand court, the relevant parts of the definition of financial services considered in that case and the definition in the New Zealand GST Act are essentially the same. The Court held that the investment manager's services were financial services (the arranging of the transfer of financial instruments).

52. The Commissioner considers that the approach applied in these cases is consistent with the approach a New Zealand court would apply to determine the true and substantial nature of the consideration provided to the recipient (the supply contracted for). This is considered objectively from the customer's perspective – in this case, a typical investor or the fund (*Auckland Institute of Studies Ltd v CIR* (2002) 20 NZTC 17,685 (HC)).

53. The degree of knowledge and skill with which a service is supplied is relevant to the quality of the service but does not determine the nature of the service.

54. Research and market analysis for the purpose of making investment decisions are important elements in the service provided to investors in a fund. However, a typical investor in a managed fund does not seek research and market analysis as ends in themselves. The purpose of a managed fund is to provide facilities for investors to participate as beneficiaries in the income and capital arising from the trust property. Investors acquire interests in a managed fund to obtain an interest in the trust's assets. Research and market analysis are carried out to establish the pool of securities in which investors have an interest as beneficiaries. Research and market analysis for the purpose of making investment decisions and implementing those decisions are inextricably linked.

55. In some cases, research and analysis may not lead to the transfer of securities. However, this would not alter the nature of the supply. When investors pay money to the manager for investment, they decide that securities the manager selects will be acquired or sold for their benefit. The manager's research and analysis activities are carried on to give effect to the investors' decision. The same process is carried out by the manager in deciding whether to buy, sell or hold securities. Research and analysis are not carried out as ends in themselves, but as part of the process by which the manager arranges for securities to be bought or sold.

56. The manager is directly involved in the process by which securities are bought or sold for the investors' benefit. As the manager has discretion to make investment decisions and the supervisor must comply with the manager's instructions (subject to any powers the supervisor may have in this regard), a direct relationship exists between the manager's research and analysis activities and the transfer of securities. The manager does not merely facilitate or enable the transfer of securities by or to the supervisor. As the manager causes the transfer of securities to occur, plans and provides for the transfer of securities, and gives instructions for the transfer of securities, the manager's investment management activities constitute arranging for the transfer of securities.

22 At [62]–[64].
23 At [64].
24 At [64].
25 At [66].

57. Therefore, the manager's activities relating to the investment of the trust property are financial services under section 3(1)(l), being arranging the supply of a financial service (the transfer of ownership of securities), so are exempt supplies of financial services.

Administration activities

58. The manager's administration activities (including services such as registry services, fund accounting, the management of financial transactions between a member and the scheme, and the management of PIE tax obligations) are not any of the activities listed in section 3(1). Therefore, these activities are not financial services. However, the supply of administrative services is an exempt supply (by virtue of section 14(1)(a)) if the services are:
   - supplied by the manager; and
   - reasonably incidental and necessary to the supply of financial services by the manager.
59. For section 14(1)(a) to apply to the supply of goods and services other than the supply of financial services:
   - the goods and services must be supplied by a person who supplies the financial services;
   - the supply of the goods and services must be reasonably incidental to the supply of financial services. This requires that the supply of the other goods and services must occur in conjunction with the supply of financial services;
   - the supply of the other goods and services must be subordinate to the supply of financial services[26]; and
   - the supply of the goods and services must be reasonably necessary to the supply of financial services. To be "reasonably necessary" to the supply of financial services, it would not be sufficient that the supply of other goods and services are merely desirable to the supply of financial services. There must be a degree of need for the supply of other goods and services to be supplied with financial services, but the supply of other goods and services need not be essential or absolutely necessary to the supply of financial services (in the sense that the financial services could not be supplied without the other goods and services being supplied)[27].
60. To summarise, a supply of non-financial services by the manager is reasonably incidental to the supply of the financial services by the manager if the supply occurs in conjunction with the supply of those financial services **and** is subordinate to the supply of the financial services. To be "reasonably necessary" to the supply of financial services by the manager, it is not enough that the administration services are merely desirable to the supply of the financial services. However, the other goods and services need not be essential or absolutely necessary to the supply of financial services (in the sense that the financial services could not be supplied without the other goods and services).
61. Fund accounting and unit pricing are reasonably incidental and necessary to the supply of financial services by the manager. Fund accounting and unit pricing are subordinate to the issue or redemption of units and are necessary to establish the price at which units are to be issued or redeemed by the manager.
62. The maintenance of a registry is also reasonably incidental and necessary to the supply of financial services. A register of members is maintained because proper records must be kept to enable the persons for whom the scheme property is held (and the extent of their interest in the scheme property) to be identified.
63. The manager must provide reports to investors because the manager receives funds from investors and must account for these funds. These reporting activities are reasonably incidental and necessary to the supply of financial services by the manager.
64. Therefore, the supply by the fund manager of services in relation to the administration of a managed fund is an exempt supply under section 14(1)(a). This is illustrated in Example | Tauira 1.

26 *Department of Health and Social Security v Envoy Farmers Ltd* [1976] 2 All ER 173; *Canadian National Railway Co v Harris* [1946] SCR 352; *CH Beazer (Holdings) plc v C & E Commrs* (1987) 3 BVC 623; *Mindell v Canadian Northern Shield Insurance Co v Mindell* [1990] BCJ No 15; *State of Victoria v Commonwealth* [1975] 7 ALR 277; *R v Sundown* [1999] 1 SCR 393; *Doom v Commissioners of Customs & Excise* (1973) VATTR 61).

27 *See R v Shayler* [2002] 2 All ER 477; *Re an Inquiry under the Company Securities (Insider Dealing) Act 1985* [1988] 1 All ER 203; *Re H-L (A child)* [2013] EWCA Civ 655; *M v The Queen* (Court of Appeal CA 819/2011; 5 April 2012); *Elcham v Commissioner of Police* [2001] NSWSC 614; *Aiken v Shaw* (1933) SLT 21.

Example | Tauira 1 – Manager providing administration services to the managed fund

Company A is the manager of a managed fund. Company A undertakes all the administration of the managed fund (such as registry services, record-keeping and reporting, tax and regulatory compliance); offers, issues, and redeems interests in the fund; and manages the scheme property and funds (including receiving and distributing income from investments, making investment decisions and exercising voting rights).

Company A's supplies to investors in the fund and the fund itself are exempt supplies. The supplies are either supplies of financial services being activities listed in section 3(1) or are reasonably incidental and necessary to those supplies of financial services.

Accordingly, no output tax is payable on the supplies by the manager.

Manager's activities are not characterised as a supply of management services

65. An argument exists that the relevant supply for a managed fund is a single supply of management services that is not an exempt supply of financial services. A transaction involves a single supply where:
    - one element in the transaction is the principal or dominant element in the supply and other elements of the transaction are incidental or ancillary to the principal supply; or
    - two or more elements (none of which is the principal or dominant supply) are so closely linked that they form objectively a single indivisible economic supply.

    See *Auckland Institute of Studies Ltd*, *Levob Verzekeringen BV v Staatssecretaris van Financiën* [2006] STC 766 (ECJ) and **IS 18/04: Goods and services tax – single supply or multiple supplies**.

66. Without a statutory definition of financial services, it may have been possible to argue that the supply made by the manager (considered as a whole) was a single supply of the management of a managed fund. The argument would be that the investors acquire an interest in securities selected by the manager and a right to share in the income from the securities. As each element of the transaction is necessary and integral to the supply sought and obtained by investors, all the manager's activities can be regarded as a single supply of services. The manager manages a fund in the sense that they control and direct the managed fund.
67. However, the scope of the exemption in respect of financial services is determined by the list of specific activities in section 3(1) (see *Gulf Harbour Development Ltd*).
68. As a financial service is "any one or more" of the activities listed in section 3(1), a financial service can consist of more than one of the activities in section 3(1). The legislation contains its own test of whether the supply of non-financial goods and services is part of a supply of financial services. If goods and services other than financial services are supplied by a person who supplies financial services and the supply of the non-financial goods and services is reasonably incidental and necessary to the supply of those financial services, the supply of the non-financial goods and services is part of the supply of the financial services and shares the same GST treatment (see at [58]).
69. The supply or supplies made by the manager are exempt from GST if:
    - each activity the manager carries on is one of the activities listed in the definition of financial services; or
    - some of the activities the manager carries on are listed in the definition of financial services and any other services supplied by the manager are reasonably incidental and necessary to the financial services supplied by the manager.

Management of a retirement scheme

70. The Commissioner acknowledges that the management of a retirement scheme is a specified financial service (section 3(1)(j)[28]) but in contrast the "management of a managed fund" is not one of the activities listed in section 3(1). It might be argued that this suggests the activities of the manager of a managed fund were not intended to be financial services.

71. However, the manager's activities include the specific activities listed in the definition of financial services in section 3(1) as well as services that are reasonably incidental and necessary to the supply of financial services by the manager (section 14(1)(a)). If the supplies made by the manager satisfy the specific paragraphs of section 3(1) they cannot be treated as taxable supplies on the basis of an argument that the activities of the manager (considered as a whole) comprise the management of a managed fund, and the management of a managed fund is not specified in section 3(1). The explicit reference to the management of a retirement scheme in section 3(1)(j) does not override the existence of the specific paragraphs of section 3(1) in relation to a managed fund.

72. Section 3(1)(j) applies to determine the GST treatment of services constituting the management of a retirement scheme. Retirement scheme is defined in section 3(2) by reference to the meaning of the term in section 6(1) of the FMCA. The definition of retirement scheme in section 6(1) of the FMCA includes a registered scheme that is a KiwiSaver scheme or a superannuation scheme (as also defined in the FMCA). "Management" refers to control, direction, planning, and decision-making. The management of a retirement scheme such as a KiwiSaver scheme or superannuation scheme will involve the control, direction, planning, and supervision of the scheme and making decisions in respect of the scheme.

73. Therefore, a manager of a managed fund that meets the definition of a "retirement scheme" will be providing an exempt supply in providing their services to the managed fund. On the basis of section 14(1)(a) this exemption will include any other goods and services the manager provides that are reasonably incidental or necessary to those services. This interpretation statement, however, is intended to cover the GST treatment of the services supplied by the manager of a scheme that is not a "retirement scheme[29]". Section 3(1)(j) has only been considered in this interpretation statement because of the argument that an absence of a similar provision for non-retirement schemes means that the management of such schemes does not involve financial services.

Issue two | Take tuarua - GST treatment of outsourced services in relation to a managed fund

74. The manager of a managed fund may enter into a contract with a third party under which the third party agrees to carry out some of the functions the manager is required to perform for the fund and investors.

75. The supplier of services is the person who is contractually obliged to supply the services, and the recipient is the person who can enforce the performance of the services (*Wilson & Horton Ltd v CIR* (1995) 17 NZTC 12,325 (CA) and *CIR v Capital Enterprises Ltd* (2002) 20 NZTC 17,511 (HC)). The manager of a managed fund supplies services to the fund on behalf of the investors. The contracting out of the services does not relieve the manager of their contractual obligations or statutory obligations to provide the services to the fund (*Tolhurst v Associated Portland Cement Manufacturers (1900) Ltd* [1902] 2 KB 660 (CA) and *Savvy Vineyards 3552 Ltd v Kakara Estate Ltd* [2015] 1 NZLR 281 (SC)).

76. Where the manager enters into a contract with a third party for the supply of any services that the manager is required to supply under its contract with the fund, there will be a:
    - supply of the services by the manager to the fund; and
    - a separate supply of equivalent services by the third party to the manager.

77. This part of the interpretation statement considers services provided for a managed fund that are supplied by a third party under a contract with the manager. The manager may contract out their administrative functions (including services such as registry services, fund accounting, the management of financial transactions between a member and the scheme, and the management of PIE tax obligations). The manager may also contract out investment management by appointing an investment manager to manage all or some of the assets of a managed fund.

28 Section 3(1)(j) includes in the term financial services "the provision, or transfer of ownership, of an interest in a retirement scheme, or the management of a retirement scheme".

29 "Restricted schemes" as defined in section 6 of the FMCA are also not covered by this statement as they are retirement schemes.

Outsourced services are not necessarily exempt supplies

78. Outsourced services are not exempt supplies merely because the services are acquired and used by the manager to make exempt supplies to investors (*CIR v Databank Systems Ltd* (1990) 12 NZTC 7,227 (PC)).

79. To be a financial service, an outsourced service must be one of the activities listed in section 3(1) in relation to the supplier (the third party) and the recipient (the manager).

80. As noted above, for the supply of goods and services other than the supply of a financial service to be an exempt supply, the:
    - goods and services must be supplied by a supplier of financial services together with the supply of financial services; and
    - supply of the goods and services must be "reasonably incidental and necessary" to the supply of those financial services (section 14(1)(a)).

81. If an outsourced service is not a financial service, the supply of the service is not an exempt supply. This is because the service is not supplied by a person who supplies financial services.

82. If any service supplied by a third party to the manager of a managed fund is a taxable supply, the manager is not likely to be entitled to an input tax deduction for those supplies. This is because the services are generally acquired by the manager for the purpose of making their exempt supplies.

Administrative services

83. The various administrative obligations of a manager that could be outsourced to a third party under a contract with the manager (such as the maintenance of a register of unitholders and the accounting functions performed by a third party) are not financial services because they are not one of the activities listed in section 3(1). (But see below at [90] for the situation where administrative services and investment management services and/or other services are outsourced to the same person.) The recording of the effect of agreements or arrangements made by the manager is not an arranging service and is not a financial service under section 3(1)(l) (*Databank* (PC) at 7,231). This is illustrated in Example | Tauira 2.

Example | Tauira 2 – Outsourced administrative services

Company B enters into a contract with a manager of a managed fund. Company B agrees to:

- keep and maintain a register of investors;
- keep records of subscriptions, units held by investors, unit prices, income entitlements and other matters that must be recorded in terms of the trust deed or any relevant legislation; and
- provide information to the manager to enable the manager to comply with the manager's statutory and contractual obligations.

As maintaining records and providing information are not any of the activities listed in the definition of financial services, the services supplied to the manager are not financial services. They also do not come within section 14(1)(a) as being the supply of other goods and services, supplied by the supplier of financial services, that are reasonably incidental and necessary to that supply of financial services. The supply of the services enables the manager to supply financial services to investors. However, the services are not part of the supply of financial services by the manager as they are supplied by a different person. Therefore, the supply of the services is not an exempt supply under section 14(1)(a) and is a taxable supply.

As these services are generally acquired by the manager for the purpose of supplying exempt supplies of financial services, the manager is not likely to be entitled to an input tax deduction.

Investment management

84. Arranging for the transfer of debt securities, equity securities or participatory securities is a financial service, but advising on the transfer of securities is not a financial service (section 3(1)(c), (d) and (l)). The meanings of "advise" and "arrange" were first discussed at [41] and [42] and are further discussed in the following paragraphs.

85. An investment manager's activities involve arranging the transfer of securities if a sufficient causal link exists between the activities and the transfer of securities. This is the case where an investment manager has full authority to both make and carry out investment decisions. However, the investment manager is not supplying an arranging service where the manager does not need to accept recommendations made by an investment manager, and the investment manager does not have authority to give instructions to the supervisor or custodian (who holds the assets of the managed fund) for the acquisition or sale of securities. In these circumstances, the essential nature of the services provided by an investment manager is the provision of advice, which is a taxable supply (see *General Motors of Canada Ltd* and *Canadian Medical Protective Assn* (discussed from [46])). The following paragraphs consider this distinction in more detail.

86. The supply of investment management carried out by a third-party investment manager is either an exempt supply of financial services or a taxable supply of advice, depending on the terms of the appointment of the third-party investment manager and the manner in which this appointment is exercised and supervised. Where an investment manager has authority to make and implement investment decisions, the investment manager makes an exempt supply of financial services because they arrange the transfer of securities (section 3(1)(l)).

87. Where an investment manager's investment recommendations are subject to a high level of oversight and scrutiny and a manager can veto the recommendations on the merits, the investment manager does not have authority to implement investment recommendations, so such an investment manager provides investment advice, which is a taxable supply. This is illustrated in Example | Tauira 3.

Example | Tauira 3 – Outsourced investment management services that are not "arranging" services

The manager of a managed fund enters into an agreement with an investment manager, Company C. Company C's obligations are to recommend investment decisions in accordance with investment guidelines agreed with the managed fund manager. Company C has no authority to give instructions to the supervisor who holds the assets of the fund to buy or sell securities or to complete settlement of securities transactions. The supervisor is not required to comply with the instructions of Company C and the transfer of securities cannot occur without the managed fund manager's approval. Notwithstanding that, the recommendations are routinely accepted by the manager and implemented for the managed fund.

Arranging the transfer of debt securities, equity securities or participatory securities is a financial service (section 3(1)(c), (d) and (l)). To be arranging the transfer of securities, a sufficient relationship must exist between the investment manager's services and a transfer of securities. As securities will be bought or sold only if the managed fund manager instructs the supervisor to do so, Company C's activities do not constitute arranging the transfer of securities. The service supplied by Company C is advising on the transfer of securities, which is specifically excluded from the definition of financial services. Therefore, Company C's services are a taxable supply.

As Company C's services are generally acquired by the manager for the purpose of supplying financial services, the manager is not likely to be entitled to an input tax deduction on Company C's services.

88. However, in some circumstances where a manager has the right to veto an investment decision made by a third-party investment manager, the service will still be an exempt supply of arranging financial services. This would be the case where an investment manager has authority to give instructions to a supervisor for the acquisition or sales of securities, and a manager's discretion to veto transactions is limited to checking that investment decisions made by the investment manager comply with the mandate. In this situation, the investment manager arranges financial services under section 3(1)(l). This is illustrated in Example | Tauira 4.

Example | Tauira 4 – Outsourced investment management services that are "arranging" services even where the manager and supervisor have a limited right to veto the investment manager's decisions

The manager of a managed fund enters into an agreement with an investment manager, Company D. Company D's obligations are to make investment decisions in accordance with investment guidelines agreed with the managed fund manager. Company D has authority to give instructions to the supervisor who holds the assets of the fund to buy or sell securities or to complete settlement of securities transactions. The manager and supervisor can intervene to countermand the instructions of Company D only where the decisions conflict with the investment mandate of the fund (or, for the supervisor, where section 160 of the FMCA applies).

Arranging the transfer of debt securities, equity securities or participatory securities is a financial service (section 3(1)(c), (d) and (l)). To be arranging the transfer of securities, a sufficient relationship must exist between Company D's services and a transfer of securities. As securities will be bought or sold if the investment manager instructs the supervisor to do so, subject to very limited "veto" powers of the managed fund manager and the supervisor, Company D's activities constitute arranging the transfer of securities. Therefore, it is an exempt supply of financial services.

Accordingly, no output tax is payable on the supply by Company D and there is no input tax for the managed fund manager.

Variation – outsourced investment management services that are "arranging" services even where the manager has a limited right to veto the investment manager's decisions, and the investment manager must give prior notice of the proposed investment decisions

The facts are as above, but Company D is required to advise the manager and supervisor of the investment decisions it proposes to make. As above, the manager and supervisor are able to intervene to countermand the instructions of Company D only where the decisions conflict with the investment mandate of the fund (or, for the supervisor, where section 160 of the FMCA applies).

Company D's activities still constitute arranging the transfer of securities. It is an exempt supply of financial services. This is even though Company D is required to advise the manager and supervisor of the proposed investment decisions ahead of time and even though there is a limited ability to not follow Company D's decisions.

Accordingly, no output tax is payable on the supply by Company D and there is no input tax for the managed fund manager.

89. For arrangements where the manager and supervisor of the managed fund have a wider legal power to override the investment decisions of an investment manager, a court is likely to consider evidence of how an investment manager's contract is given effect to in practice. Evidence that investment decisions of an investment manager are not closely scrutinised by the manager, and transactions are largely made without any intervention by the manager or supervisor would support a finding that the investment manager is supplying an arranging service. This is illustrated in Example | Tauira 5.

Example | Tauira 5 – Outsourced investment management services that are "arranging" services where the manager has the right to not follow the investment manager's decisions but in practice never exercises that right

The manager of a managed fund enters into an agreement with an investment manager, Company E. Company E's obligations are to make investment decisions in accordance with investment guidelines agreed with the managed fund manager. Company E has authority to give instructions to the supervisor who holds the assets of the fund to buy or sell securities or to complete settlement of securities transactions. However, the manager and supervisor have a right to intervene to countermand the instructions of Company E in circumstances where they disagree with Company E's decisions.

The longstanding practice of both the manager and supervisor is to follow the decisions of Company E, and the only real scrutiny of those decisions is to ensure they satisfy the investment mandate (and to ensure no breach of section 160 of the FMCA). The only time decisions have been countermanded was where the investment mandate was inadvertently breached.

Arranging the transfer of debt securities, equity securities or participatory securities is a financial service (section 3(1)(c), (d) and (l)). To be arranging the transfer of securities, a sufficient relationship must exist between Company E's services and a transfer of securities. In practice, securities are bought or sold if Company E instructs the supervisor to do so subject to very limited "veto" powers of the managed fund manager and the supervisor, so Company E's activities constitute arranging the transfer of securities. It is an exempt supply of financial services. This is even though the manager and supervisor have a more general power to not follow Company E's decisions (compared with Example | Tauira 4).

Accordingly, no output tax is payable on the supply by Company E and there is no input tax for the managed fund manager.

Exempt investment management and/or other financial services and administration outsourced to the same person

90. Where exempt investment management[30] and/or other financial services (for example, the issue and redemption of units in the fund) are outsourced, together with administrative services, it will be a question of fact whether those administrative services are "reasonably incidental and necessary" to the various exempt supplies of financial services. In some cases that may be clearly the case (for example, where the fund manager outsources all of their activities to the same third party such that the administrative services must support the financial services supplied by the third party). In other cases it may be less clear (for example, where investment management and administrative services are outsourced to the same third party, but not all the administrative services can be said to support the financial services involved with exempt investment management).
91. Each factual situation will need to be carefully scrutinised in terms of the test for reasonably incidental and necessary (see above at paragraphs 59 and 60), and it is not possible to make a broad statement in the absence of particular facts.
92. **Example** | Tauira 6 illustrates these points.

Example | Tauira 6 – A manager fully outsources services to a third party

The manager of a managed fund enters into an agreement with Company F which involves the manager outsourcing to Company F all the services the manager must provide to the fund. This includes investment management (of a type that means Company F is arranging the transfer of securities and not just advising), the issue and redemption of units, the collection and payment of sums in relation to securities, and all associated administrative services that the manager was responsible for.

Company F's services of investment management (section 3(1)(l)), the issue and redemption of units (sections 3(1)(c) and (d)), and the collection or payment of amounts in respect of securities (section 3(1)(ka)) are all financial services and therefore exempt supplies.

The administrative services Company F provides are reasonably incidental and necessary to the supplies of financial services and therefore also exempt by virtue of section 14(1)(a). This is for the same reasons discussed in [61] to [64] and illustrated in Example 1. The administrative services are provided together with the financial services and are subordinate to them and are also necessarily undertaken to make those supplies of financial services.

Variation – the manager outsources investment management and administrative services to a third party

As a variation on the above, the manager only outsources to Company F the investment management of the managed fund and all the administrative services the manager is required to undertake. These administrative services relate to all the different functions that the manager is obliged to fulfil, including the investment management.

As above, the investment management will be a financial service and an exempt supply (as Company F is arranging the transfer of securities and not just advising).

However, the administrative services Company F provides are not all reasonably incidental and necessary to its supplies of financial services (which are only the supplies of investment management) and therefore are not all exempt by virtue of section 14(1)(a).

30 Based on the discussion above about when outsourced investment management will be exempt as "arranging" or taxable as "advising".

The administrative services provided together with the investment management will be reasonably incidental and necessary to Company F's financial services of investment management, as they are subordinate to them and are also necessarily undertaken to make those supplies of financial services.

On the other hand the administrative services provided by Company F in relation to the manager's own supplies of financial services (that is, the services that were not outsourced) do not satisfy the test of being reasonably incidental and necessary to a supply of financial services made by Company F so as to satisfy section 14(1)(a).

(These conclusions (for both the first part of the example and the variation) would not change if Company F was a group company.)

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Legislative references | Tohutoro whakatureture

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Goods and Services Tax Act 1985; sections 3 ("contributory scheme", "financial services", "participatory security"), 14

Income Tax Act 2007, ss CW 45, HD 13, YA 1 ("unit trust")

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Canadian Medical Protective Assn v R [2009] FCA 115

Canadian National Railway Co v Harris [1946] SCR 352

CH Beazer (Holdings) plc v C & E Commrs (1987) 3 BVC 623

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

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IS 25/06: Employer obligations for employee share scheme benefits paid in cash

Issued | Tukuna: 31 March 2025

This interpretation statement explains an employer's PAYE, student loan and KiwiSaver obligations when an employee receives a benefit under an employee share scheme that is paid in cash.

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

START DATE | RĀ TĪMATA

This interpretation statement applies to an employee share scheme benefit paid in cash on or after 1 November 2024.

REPLACES | WHAKAKAPIA

- This interpretation statement updates and replaces **IS 24/05: Employer obligations for employee share scheme benefits paid in cash** for the amendments to s 11(1)(cb) of the Accident Compensation Act 2001 by the Taxation (Annual Rates for 2024-25, Emergency Response, and Remedial Measures) Act 2025.

Summary | Whakarāpopoto

1. An employee share scheme (ESS) benefit is usually provided in **shares**. In this situation, the employer can elect to withhold and pay tax on the share benefit. However, there is no requirement for the employer to withhold tax. If the employer elects to withhold tax they must also deduct student loan repayments (if any) but Accident Compensation Corporation (ACC) earners' levy and KiwiSaver do not apply.
2. The purpose of the election is to simplify tax compliance for the employee. If no election is made the employer must generally still report the value of the benefit to Inland Revenue in its employment income information (EI) and the employee pays tax on the benefit through the end-of-year tax return process. Withholding is not compulsory because of concerns that it may impose additional compliance costs on employers.[1]
3. In some circumstances, an employee may receive **cash** instead of shares under an ESS (a **cash-settled ESS benefit**). The following questions arise when an employee receives a cash-settled ESS benefit:
    - Is the employer required to withhold tax (and student loan, if any) from the benefit (on the basis that a cash benefit is an ordinary extra pay) or does the employer have the choice to withhold as they do if the benefit is provided in shares?
    - Does an employer have to withhold ACC earners' levy or have KiwiSaver obligations?
4. An employee might receive cash under a share scheme in various scenarios, such as the following:
    - The employer reserves the right to provide cash instead of shares under the terms of the scheme.
    - The employee can choose to receive cash instead of shares under the terms of the scheme.
    - The terms of the scheme include flexibility to vary the scheme and pay cash in specific situations (eg when the company is sold or an employee retires).
    - The scheme is a phantom share scheme, where amounts are always paid in cash.
5. If the cash is a "benefit" under an ESS, some tax rules apply differently compared to other cash payments. Accordingly, the first step is to clarify whether the cash the employee receives is truly a cash-settled ESS benefit. This involves considering two questions:
    - Is the scheme an "employee share scheme"?
    - Does the amount give rise to a "benefit" under an ESS?

1 For more information on withholding tax from an ESS benefit provided in shares see **IS 25/07: PAYE – How an employer funds the tax cost on an employee share scheme benefit**.

6. Broadly, the scheme will be an "employee share scheme" if it is an arrangement with a purpose or effect of issuing or transferring shares in a company to an employee. The relevant time to assess this requirement is when the scheme is entered into. The arrangement must also be connected to the employee's employment or service.
7. A phantom share scheme is an example of a scheme that is not an "employee share scheme" for tax purposes. This is because, under a phantom share scheme, an employee never becomes a shareholder in the company. The benefits are always paid out in cash. In this case, the amount will generally be an ordinary cash bonus and subject to the usual PAYE rules.
8. A cash amount will give rise to a "benefit" under an ESS if the share scheme taxing date is triggered by a transfer or cancellation of shares or related rights under the ESS and the cash is paid for this transfer or cancellation.
9. An example of an ESS where the cash amount will not generally give rise to a "benefit" under the scheme is where under the terms of the ESS the incentive is paid partly in cash and partly in shares. The part that is paid in cash is likely to be paid in satisfaction of the rights to cash granted under the scheme (ie there is no transfer or cancellation of rights to shares). In this situation, the cash amount will generally be an ordinary cash bonus and subject to the usual PAYE rules.
10. Once it has been established that a cash amount is a cash-settled ESS benefit, the following outcomes arise:
    - The cash-settled ESS benefit is an "extra pay" under the general definition of extra pay and a PAYE income payment.
    - The employer is required to withhold tax at the applicable extra pay rate (and deduct student loan, if applicable).
11. The employer is not required to deduct ACC earners' levy from a cash-settled ESS benefit. This is because ESS benefits are excluded from the definition of "earnings as an employee" for the purposes of the Accident Compensation Act 2001.
12. The employer is not required to make KiwiSaver deductions or employer contributions on a cash-settled ESS benefit. This is because KiwiSaver deductions and contributions are based on an employee's gross "salary or wages" and a cash-settled ESS benefit is excluded from the definition of "salary or wages" for the purposes of the KiwiSaver Act 2006.
13. The election to withhold tax from an ESS benefit applies only to share-settled benefits (ie non-cash benefits). An employer cannot make an election to withhold tax (or choose not to withhold tax) where withholding is already required. This conclusion reflects the purpose of the legislation (to simplify tax compliance for an employee) and the statutory context (to tax employment income at source).
14. The key questions relevant to determining an employer's PAYE, student loan and KiwiSaver obligations for awards provided to an employee under a share scheme are summarised in Figure | Hoahoa 1, which is before the **Examples | Tauira**.
15. This interpretation statement does not consider the implications of any anti-avoidance provisions. The outcomes set out may not apply where the general anti-avoidance provision (s BG 1) or the specific ESS anti-avoidance provision (s GB 49B) applies.

Introduction | Whakataki

Overview of the issues

16. Most employment income or benefits are taxed at source under the PAYE or FBT rules. However, generally, employee share scheme (ESS) benefits are treated differently. While employers must report the value of the benefit in their EI return (with an exception for some former employees), they generally have a choice about whether to withhold tax under the PAYE rules. Accident Compensation Corporation (ACC) earners' levy and KiwiSaver obligations do not apply to ESS benefits.
17. An ESS benefit is usually provided in shares. It is clear how the PAYE rules work in relation to share-settled benefits. However, in some circumstances an employee may receive cash instead of shares. An issue arises as to whether an employer is required to withhold tax (and student loan repayments, if any) from a cash benefit (on the basis that a cash benefit is an ordinary extra pay) or has the choice to withhold as they do if the benefit is provided in shares. A related question is whether an employer has to withhold ACC earners' levy or has KiwiSaver obligations when an ESS benefit is provided in cash.

18. This interpretation statement explains the Commissioner's position on those issues. It also considers the circumstances in which a cash payment provided to an employee under an ESS is a cash-settled ESS benefit. The statement considers the following four questions:
    - What is a cash-settled ESS benefit?
    - Is an employer required to withhold tax from a cash-settled ESS benefit?
    - Is an employer required to deduct student loan repayments from a cash-settled ESS benefit?
    - What are an employer's KiwiSaver obligations for a cash-settled ESS benefit?
19. This statement only applies where the person receiving the benefit is an employee (under a contract of service).[2] It considers an employer's PAYE (including the ACC earners' levy), student loan and KiwiSaver obligations. Generally, a child support deduction notice will not apply to an ESS benefit. However, if an employer has any questions about whether to make a child support deduction, they should contact Inland Revenue. This statement does not consider child support deductions any further.

Assumptions in this interpretation statement

20. This interpretation statement focuses on whether a cash benefit received under an ESS is treated differently for PAYE, student loan and KiwiSaver purposes to a benefit received in shares. For clarity and simplicity, where a technical requirement is not directly relevant to answering this question, it is assumed that the requirement has been met or does not apply. This statement will explicitly state where such assumptions have been made.

What is a cash-settled employee share scheme benefit?

21. This interpretation statement uses the term "cash-settled ESS benefit" to describe a benefit received under an ESS that is provided in cash rather than shares.
22. Broadly, an employee might receive cash in the following situations:
    - The employer reserves the right to provide cash instead of shares under the terms of the scheme.
    - The employee can choose to receive cash instead of shares under the terms of the scheme.
    - The terms of the scheme include flexibility to vary the scheme (including to cancel awards for market consideration in cash) in specific situations (eg when the company is sold or an employee retires).
    - The scheme is a phantom (or shadow) share (or option) scheme.[3]
23. When considering an employer's withholding obligations, it is necessary to understand the nature of the income received. In the case of a cash-settled ESS benefit, it is important to be sure that the cash amount received is in fact a benefit received under an ESS (as defined in the legislation) and not, for example, a cash bonus.
24. A benefit received under an ESS is income under s CE 1(1)(d), while a cash bonus is income under s CE 1(1)(a).

> **CE 1 Amounts derived in connection with employment**
>
> *Income*
>
> (1) The following amounts derived by a person in connection with their employment or service are income of the person:
>
> (a) salary or wages or an allowance, bonus, extra pay, or gratuity;
>
> …
>
> (d) a benefit received under an employee share scheme:
>
> …

2 It does not consider the treatment of cash-settled ESS benefits provided to an independent contractor, for example, a non-executive director.

3 A phantom share scheme can operate in a variety of ways, but the key point is that the employee does not become a shareholder in the company. The benefits of a phantom share scheme are paid out in cash.

25. The requirements for an amount[4] to be income under s CE 1(1)(d) are that the amount:
- must be derived in connection with the employment or service of the person;
- must be received under an "employee share scheme" as defined in s CE 7; and
- must give rise to a "benefit" under s CE 2.

26. The first requirement applies to all amounts that are income under s CE 1(1) (eg salary or wages, a bonus, extra pay or gratuity). It is not directly relevant to the question of whether a cash benefit is an ESS benefit or something else, for example a bonus. This statement assumes that the cash payment in question is derived in connection with an employee's employment.

27. The second and third requirements determine whether the amount is a benefit received under an ESS and these are set out below.

Is the amount received under an "employee share scheme"?

28. "Employee share scheme" is defined in s CE 7.

> **CE 7 Meaning of employee share scheme**
>
> Employee share scheme means—
>
> (a) an arrangement with a purpose or effect of issuing or transferring shares in a company (**company A**) to a person—
>
> (i) who will be, is, or has been an employee of company A or of another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:
>
> (ii) who will be, is, or has been a shareholder-employee in relation to company A or in relation to another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:
>
> (iii) who is an associate of a person described in subparagraph (i) or (ii) (person A), if the arrangement is connected to person A's employment or service; but
>
> (b) does not include an arrangement that—
>
> (i) is an exempt ESS:
>
> (ii) requires market value consideration to be paid by a person described in paragraph (a) for the transfer of shares in the company on the share scheme taxing date:
>
> (iii) requires a person described in paragraph (a) to put shares, acquired by them for market value consideration, at risk, if the arrangement provides no protection against a fall in the value of the shares and none of the consideration for acquiring the shares is provided to the person under an agreement that it is used for acquiring the shares.

29. Broadly, an ESS is an arrangement:
- with a purpose or effect of issuing or transferring shares in a company to a person who will be, is, or has been an employee (or shareholder-employee) of that company or another company in the same group; and
- that is connected to the employee's (or shareholder-employee's) employment or service.

30. An employee and shareholder-employee are persons described in s CE 7(a)(i) and (ii). An ESS also includes providing shares to an associate of an employee or a shareholder-employee (being a person described in s CE 7(a)(iii)) if the arrangement is in connection with the employee or shareholder-employee's employment or service.

31. Accordingly, the person who receives shares under an ESS could be the employee, shareholder-employee or an associate (and such a person is an "employee share scheme beneficiary" under s CE 7C). Regardless of who receives the shares, it is the employee or shareholder-employee that derives any employment income from the ESS as set out in s CE 1(1)(d) and s CE 2 (see [48] and [49]). This is because s CE 2(1) provides that a person who is described in s CE 7(a)(i) or (ii) (being the employee or the shareholder-employee) receives the benefit calculated under s CE 2, and therefore the income under s CE 1(1)(d).

4 An amount includes an amount in money's worth (s YA 1).

32. When a person receives cash instead of shares under an incentive scheme, the key issue is whether the scheme is "an arrangement with a purpose or effect of issuing or transferring shares" in a company to a person (s CE 7(a)). The relevant questions are:
   - Is there an arrangement?
   - Does the arrangement have a purpose or effect of issuing or transferring shares in a company to a person?
33. Whether the amount received is cash rather than shares does not affect the other requirements of the definition of "employee share scheme". Therefore, this statement assumes the other requirements of the definition of "employee share scheme" are met. That is:
   - the person will be, is or has been an employee (or shareholder-employee) of the company or of another company in the same group (or is an associate of the employee or shareholder-employee);
   - the arrangement is connected to the employee's (or shareholder-employee's) employment or service; and
   - none of the exclusions in s CE 7(b) apply.
34. For simplicity, where this interpretation statement refers to an employee, it includes a shareholder-employee or an associate of the employee or shareholder-employee in question (as relevant).

Is there an arrangement?

35. An "arrangement" is defined in s YA 1:

> **Arrangement** means an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect.

36. The use of the term "arrangement" in the definition of "employee share scheme" covers all aspects of a scheme, for example, direct transfers of shares, loans to buy shares, bonuses, put and call options, and transfers to trusts.[5]
37. An ESS will ordinarily be an "arrangement" and will typically consist of more than one document, for example, an offer letter, an acceptance form and the share scheme rules.

Does the arrangement have a purpose or effect of issuing or transferring shares in a company to a person?

38. When **cash is received** instead of shares under an incentive scheme, the key issue is whether the arrangement has **a purpose or effect of issuing or transferring shares** in a company to a person.
39. The courts have considered the words "purpose or effect" in a tax avoidance context.[6] The following are the main points from those cases that are relevant to an ESS:
   - The courts tend to treat the phrase "purpose or effect" as a composite term. That is, although presented as alternatives, the words do not have any real difference in meaning because the purpose is deduced from the effect.
   - The purpose or effect of an arrangement is determined objectively. The subjective motives, intentions or purposes of the parties are not relevant.
   - The objective purpose of the arrangement is determined by considering the intended effect of the arrangement (or the effect that the arrangement sought to achieve).
   - The effect of an arrangement must be ascertained from the terms of the arrangement.
   - The analysis does not depend on hindsight. The relevant time to consider the purpose or effect of an arrangement is the time the arrangement was entered into. The arrangement is not judged on the basis of what actually happened afterwards.
40. Following this approach, the starting point is to consider the terms of the arrangement in order to see what the effect of the arrangement is (ie what it does). This is considered at the time the arrangement is entered into and does not depend on hindsight. The effect of the arrangement will be its objective purpose.

5 **Employee share schemes** *Tax Information Bulletin* Vol 30, No 5 (June 2018): 53

6 For more on the meaning of "purpose or effect", see **IS 23/01: Tax avoidance and the interpretation of the general anti-avoidance provisions sections BG 1 and GA 1 of the Income Tax Act 2007** *Tax Information Bulletin* Vol 35, No 2 (March 2023).

41. In an **ordinary share scheme** where an employee receives shares on vesting or when options are exercised, the effect of the terms of the arrangement is that shares will be transferred (or issued) to the employee. The purpose is the intended effect (or the effect the arrangement seeks to achieve). In this case, the arrangement is an ESS (assuming the conditions of s CE 7(a)(i) to (iii) are met and none of the exclusions in s CE 7(b) apply).
42. In the situation where the terms of a scheme mimic those of an ordinary share or option scheme but **the incentive is always paid in cash**, the arrangement clearly does not have a purpose or effect of transferring or issuing shares. This type of arrangement is commonly referred to as a phantom share scheme and is not an ESS for tax purposes. See Example | Tauira 1.
43. In the situation where the terms of the arrangement provide for the award to be settled **partly in shares and partly in cash**, **an** intended effect of the arrangement is to transfer shares to the employee. A purpose of the arrangement is therefore also to transfer shares to the employee. The use of the word "a" before "purpose or effect" in s CE 7(a) shows that transferring shares does not have to be the sole or even principal purpose or effect of the arrangement. See Example | Tauira 2.
44. In the situation where the employer grants share or option rights to an employee but reserves the right to provide **cash instead of shares** on vesting or exercise of the options under the terms of the arrangement, the intended effect of the arrangement is to transfer either cash or shares. This means there is a purpose of transferring shares. See Example | Tauira 3.
45. Another situation that commonly arises is where the terms of the arrangement state that an employee will receive shares on vesting (or when an option is exercised) but the agreement also allows for an employer to **cancel the rights and provide cash** based on the market value of the shares in certain circumstances (eg on the sale of the company or retirement of an employee). Here, the effect of the terms of the arrangement is that shares will be transferred to the employee in the normal course of events. Although the terms of the arrangement also contemplate that shares may not be transferred to an employee in certain circumstances, this possibility does not prevent the arrangement from having a purpose or effect of transferring shares to an employee. See Example | Tauira 6 and Example | Tauira 7.
46. Generally, if the terms of the arrangement allow for the employer to issue or transfer company shares to an employee, the arrangement will have a purpose or effect of issuing or transferring shares even in circumstances where shares are not in fact issued or transferred.

Does the cash payment give rise to a "benefit" under s CE 2?

47. The third requirement for an amount to be income under s CE 1(1)(d) (a benefit received under an ESS) is that the amount gives rise to a "benefit" under s CE 2.

48. An employee receives a benefit in relation to shares or related rights (eg options) under an ESS equal to the amount calculated using the formula in s CE 2(1) and (2).

> CE 2 Benefits under employee share schemes
>
> *Benefit*
>
> (1) A person who is an employee share scheme beneficiary described in section CE 7(a)(i) or ii) receives a benefit for the purposes of section CE 1(1)(d) in relation to shares or related rights under the employee share scheme equal to the positive amount calculated on the share scheme taxing date using the formula—
>
> share value − consideration paid + consideration received − previous income.
>
> *Definition of items in formula*
>
> (2) In the formula in subsection (1),—
>
> (a) share value is the market value of the shares or related rights owned by an employee share scheme beneficiary on the share scheme taxing date, if the share scheme taxing date is not triggered by a transfer or cancellation of the shares or related rights:
>
> (b) consideration paid is the amount of consideration paid or payable by an employee share scheme beneficiary in relation to the transfer of the shares or related rights under the employee share scheme:
>
> (c) consideration received is the amount of consideration paid or payable to an employee share scheme beneficiary in relation to a transfer or cancellation of the shares or related rights under the employee share scheme, not including relevant shares or related rights under a replacement employee share scheme:
>
> (d) previous income is the total amount of income under section CE 1(1)(d) that the employee share scheme beneficiary has in relation to the shares or related rights before the date that is 6 months after the date of Royal assent for the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018.
>
> …

49. Importantly, the amount of the benefit is calculated on the "share scheme taxing date" and the items in the formula that will be relevant depend on what triggers the share scheme taxing date (s CE 2(1) and (2)). "Share scheme taxing date" is defined in s CE 7B:

> **CE 7B Meaning of share scheme taxing date**
>
> *Meaning*
>
> (1) Share scheme taxing date means, in relation to shares or related rights under an employee share scheme, the earlier of the following dates:
>
> (a) the first date when the shares are held by or for the benefit of an employee share scheme beneficiary (beneficial ownership) and after which, under the provisions of the scheme,—
>
> (i) there is no material risk that beneficial ownership may change or that a right or requirement in relation to the transfer or cancellation of the shares may operate; and
>
> (ii) there is no benefit accruing to the employee share scheme beneficiary in relation to a fall in value of the shares; and
>
> (iii) there is no material risk that there will be a change in the terms of the shares affecting the value of the shares:
>
> (b) the date when the shares or related rights of an employee share scheme beneficiary are cancelled or are transferred to a person who is not associated with a beneficiary described in section CE 7(a)(i) or (ii).
>
> *Exclusions*
>
> (2) For the purposes of applying subsection (1), the following requirements and rights are ignored:
>
> (a) a right or requirement in relation to transfer by the employee share scheme beneficiary for market value consideration at the time of the transfer:
>
> (b) a right or requirement that is not contemplated by the employee share scheme's provisions:
>
> (c) a right or requirement that, at the time it came into existence, had no material risk of operating or no material commercial significance:
>
> (d) a right or requirement in relation to the transfer of shares, if the right or requirement is 1 that also applies to shares not under the employee share scheme.

50. The share scheme taxing date is the earlier of the dates specified in paras (a) and (b) of s CE 7B(1). Paragraph (a) is the date when shares are held by or for the benefit of the ESS beneficiary and there are no provisions in the scheme that would defer that date under subparas (i) to (iii). Paragraph (b) is the date when the shares or related rights are cancelled or transferred to a person who is not associated with the employee (eg the employer).

51. The items in the benefit calculation formula set out in s CE 2(1) that are relevant depend on what triggers the share scheme taxing date. Generally:
    - When the share scheme taxing date is triggered by shares being held by or for the benefit of the employee (share ownership) under s CE 7B(1)(a), the relevant item in the benefit calculation formula is "share value" as defined in s CE 2(2)(a) (being the market value of the shares on the share scheme taxing date) less any "consideration paid" as defined in s CE 2(2)(b) (being the amount of the consideration paid by the employee for the shares). See Example | Tauira 5.
    - When the share scheme taxing date is triggered by the cancellation or transfer of the shares or related rights under s CE 7B(1)(b), the relevant item in the benefit calculation formula is "consideration received" as defined in s CE 2(2)(c) (being the cash paid or payable to the employee in relation to that transfer or cancellation) less any "consideration paid" as defined in s CE 2(2)(b) (being the amount of consideration paid by the employee in relation to the shares or rights). See Example | Tauira 3, Example | Tauira 4, Example | Tauira 6 and Example | Tauira 7.

52. Accordingly, for the purposes of this statement, what triggers the share scheme taxing date determines whether a "benefit" under an ESS is received in shares (s CE 7B(1)(a) and s CE 2(2)(a)) or cash (s CE 7B(1)(b) and s CE 2(2)(c)).

53. Not all cash paid to an employee under an ESS will give rise to an ESS benefit. For example, in the situation where the terms of an ESS state that an incentive will be paid partly in cash and partly in shares, then the part of the incentive that is paid in cash will not be paid in relation to a transfer or cancellation of shares or related rights under an ESS. In other words, the payment would not trigger the share scheme taxing date under s CE 7B(1) and therefore no benefit under s CE 2 would arise. The cash incentive would instead be a bonus or extra pay and income to the employee under s CE 1(1)(a). The part of the incentive scheme that is settled in shares would trigger the share scheme taxing date under s CE 7B(1)(a) and give rise to a benefit under an ESS and income to the employee under s CE 1(1)(d). See Example | Tauira 2.

54. Another example is where an employer pays a bonus to cover the employee's tax liability in relation to a share-settled ESS benefit. Although the bonus might be part of the ESS arrangement, it is not an amount paid to the employee in relation to a transfer or cancellation of the shares or related rights under the ESS. In other words, the bonus would not trigger the share scheme taxing date under s CE 7B(1) and therefore no benefit under s CE 2 would arise. The cash paid in that situation would instead be a bonus or extra pay and income to the employee under s CE 1(1)(a).

55. It is worth noting that the deduction for the employer under s DV 27(5) also expressly identifies that other employment income may arise under an ESS. Section DV 27(5) is intended to preserve a deduction for the cost of paying a bonus where the payment of the bonus is part of the terms of the ESS.[7] Another example is when the employer pays a bonus to facilitate the employee repaying a loan on vesting (where the loan was used to purchase the shares). Section DV 27(5) states:

> **DV 27 Employee share schemes**
>
> *When this section applies*
>
> (1) This section applies when a person is party to an employee share scheme.
>
> *No deduction except as provided by this section*
>
> (2) Except as provided by this section, the person is denied a deduction for an amount of expenditure or loss for an income year incurred in relation to the employee share scheme.
>
> …
>
> *Employment income*
>
> (5) The person is allowed a deduction for an amount of expenditure or loss incurred on employment income other than under section CE 1(1)(d) (Amounts derived in connection with employment).
>
> …

7 **Employee share schemes** (June 2018) at 64

Summary

56. A "cash-settled ESS benefit" is not defined in the legislation. It is a term used in this statement to describe a cash payment that is made to an employee where:
    - the employee receives the amount under an "employee share scheme"; and
    - the amount gives rise to a "benefit" under an ESS.
57. Broadly, an amount will be received under an "employee share scheme" if the scheme is an arrangement with a purpose or effect of issuing or transferring shares in a company to an employee. This requirement is assessed when the scheme is entered into. If the terms of the scheme allow for shares to be issued or transferred to an employee, then there will generally be a purpose or effect of issuing or transferring shares even in circumstances where the shares are not ultimately transferred to the employee in question. The arrangement must also be connected to the employee's employment or service.
58. A cash amount will give rise to a benefit under an ESS if the share scheme taxing date is triggered by a transfer or cancellation of shares or related rights under s CE 7B(1)(b) and the cash amount is paid in relation to that transfer or cancellation.

Is an employer required to withhold tax from a cash-settled employee share scheme benefit?

59. An employer's withholding obligations are set out in s RA 5:[8]

> **RA 5 Tax obligations for employment-related taxes**
>
> *Withholding and payment obligations*
>
> (1) A person who makes a payment or provides a benefit of 1 of the following kinds must either withhold and pay, or pay, the amount of tax for the payment or benefit to the Commissioner under subpart RD (Employment-related taxes) by the due dates:
>
> (a) a PAYE income payment:
>
> (b) a fringe benefit:
>
> (c) an employer's superannuation cash contribution.
>
> *Timing for PAYE income payments*
>
> (2) An amount of tax withheld from a PAYE income payment must be withheld at the time the person makes the payment.

60. An employer is required to withhold and pay (or pay) tax for a PAYE income payment, a fringe benefit and an employer's superannuation cash contribution. An ESS benefit is not a superannuation cash contribution or a fringe benefit.[9] Therefore the question is whether an ESS benefit (and in particular a cash-settled ESS benefit) is a "PAYE income payment". If it is, then an employer will be required to withhold tax from the payment.

8 See also s BE 1(1) (Withholding liabilities – PAYE income payments) and s RD 1 (Employment-related taxes – Introductory provision).

9 An ESS benefit is excluded from being a fringe benefit because it is included in the assessable income of an employee under s CE 1(1)(d). (See s CX 4.)

61. "PAYE income payment" is defined in s RD 3:

> **RD 3 PAYE income payments**
>
> *Meaning generally*
>
> (1) The PAYE rules apply to a **PAYE income payment** which—
>
> (a) means—
>
> (i) a payment of salary or wages, see section RD 5; or
>
> (ii) extra pay, see section RD 7; or
>
> (iii) a schedular payment, see section RD 8:
>
> (b) does not include—
>
> (i) an amount attributed under section GB 29 (Attribution rule: calculation):
>
> (ii) an amount paid to a shareholder-employee in the circumstances set out in section RD 3B or RD 3C:
>
> (iii) an amount paid or benefit provided, by a person (the claimant), who receives a personal service rehabilitation payment from which an amount of tax has been withheld at a rate specified in section RD 10B.
>
> …

62. A PAYE income payment means a payment of salary or wages, an extra pay or a schedular payment.[10]

63. "Salary or wages" (s RD 5) and "extra pay" (s RD 7) are payments made to a person in connection with their employment. Salary or wages are generally regular amounts, and an extra pay is generally a one-off amount. They are defined separately because the amount of tax withheld from an extra pay is calculated differently to PAYE on salary or wages.

64. Because a cash-settled ESS benefit is generally a one-off payment, the starting point is whether it is an extra pay. If an amount is an "extra pay", then it is excluded from being salary or wages (s RD 5).[11]

Is a cash-settled employee share scheme benefit an extra pay?

65. An extra pay is relevantly defined in s RD 7.[12]

> **RD 7 Extra pay**
>
> *Meaning*
>
> (1) An **extra pay**—
>
> (a) means a payment that—
>
> (i) is made to a person in connection with their employment; and
>
> (ii) is not a payment regularly included in salary or wages payable to the person for a pay period; and
>
> (iii) is not overtime pay; and
>
> (iv) is made in 1 lump sum or in 2 or more instalments; and
>
> (b) includes a payment of the kind described in paragraph (a) made—
>
> (i) as a bonus, gratuity, or share of profits; or
>
> (ii) as a redundancy payment; or
>
> (iii) when the person retires from employment; or
>
> (iv) as a result of a retrospective increase in salary or wages, but only to the extent to which it accrues from the start of the increase until the start of the first pay period in which the increase is included in salary or wages; and
>
> (bb) includes a benefit under section CE 1(1)(d) (Amounts derived in connection with employment) in relation to which the employer has made an election under section RD 7B to withhold an amount of tax; and
>
> …
>
> (d) does not include a payment of exempt income.
>
> …

10 This interpretation statement assumes that none of the exclusions in s RD 3(1)(b) apply.

11 Whether a cash-settled ESS benefit can in some circumstances be a schedular payment is outside the scope of this interpretation statement. This statement only considers cash-settled ESS benefits where the recipient of the benefit is an employee (under a contract of service).

12 This statement assumes that a cash-settled ESS benefit is not a payment of exempt income under para (d).

66. Paragraph (a) of s RD 7 sets out the general definition of "extra pay". It defines what an extra pay **means** for tax purposes. A cash-settled ESS benefit will generally fall within the definition of extra pay for the following reasons:
    - It is a payment of cash.
    - The payment is made to an employee in connection with their employment. It is a requirement of the definition of "employee share scheme" that the arrangement is connected to the person's employment or service so this requirement is met. In other words, if a cash payment is a benefit under an ESS (ie the ESS benefit has come into fruition under s CE 7B(1)(b)) then the payment will be connected with the employee's employment.
    - The payment is not a payment regularly included in salary or wages payable to the person for a pay period.
    - The payment is not overtime pay.
    - The payment is made in one lump sum or two or more instalments (ie a payment is still an "extra pay" even if it is not made in one lump sum).
67. Therefore, the starting point is that a cash-settled ESS benefit provided to an employee will generally be an "extra pay" under the general definition of extra pay in s RD 7(1)(a).
68. The amount of the payment is the amount of the benefit in cash under the formula in s CE 2(1). This will generally be the amount paid to the employee for the transfer or cancellation of shares or related rights (which includes a payment for the cancellation of a share option). Sometimes the employee might have paid an amount to acquire shares at the outset. In this situation, the Commissioner considers that the payment will be the net amount of the benefit in cash.
69. For completeness, a share-settled ESS benefit is not an extra pay under s RD 7(1)(a). This is because a "payment" in the context of employment income and the PAYE rules is generally considered to be a sum of money. A share-settled benefit is a non-cash benefit and as such is not a "payment".
70. Paragraph (b) of s RD 7 gives examples of the types of payments that fall within the general definition of "extra pay". The words "of the kind" indicate that the list of payments is intended to be illustrative or explanatory rather than exhaustive.[13] The word "includes" here is a further indication that the list is not intended to be exhaustive.[14]
71. Given the payments listed in para (b) are intended to be illustrative rather than exhaustive, the fact that a cash-settled ESS benefit is not specified in para (b) does not prevent it from being an extra pay under para (a).
72. Paragraph (bb) of s RD 7 relates specifically to ESS benefits. It has been suggested that this reference to ESS benefits means that such benefits should not constitute an extra pay as defined unless para (bb) is satisfied. It is helpful to consider how para (bb) applies to share-settled ESS benefits before considering whether it applies to cash-settled ESS benefits.

Paragraph (bb) – share-settled benefits

73. For ease of reference, para (bb) is restated here:

> **RD 7 Extra pay**
>
> *Meaning*
>
> (1) An **extra pay**—
>
> …
>
> (bb) includes a benefit under section CE 1(1)(d) (Amounts derived in connection with employment) in relation to which the employer has made an election under section RD 7B to withhold an amount of tax;

74. The requirements for a benefit to be an extra pay under para (bb) are that:
    - it must be a benefit under s CE 1(1)(d); and
    - the employer must have made an election under s RD 7B to withhold an amount of tax in relation to the benefit.
75. A share-settled ESS benefit is a benefit under s CE 1(1)(d) (ie a benefit received under an ESS).
76. Section RD 7B sets out when an employer has made an election to withhold tax from an ESS benefit.

13 *Northland Environmental Protection Society Inc v Chief Executive of the Ministry for Primary Industries* [2019] 1 NZLR 257 at [48] considers the words "such as" in a similar context.

14 R Carter, *Burrows and Carter Statute Law in New Zealand* (6th ed, LexisNexis, Wellington, 2021) at 568

RD 7B Treatment of employee share schemes

When this section applies

(1) This section applies for employees or a former employee in relation to benefits under an employee share scheme, if—

(a) an employer has irrevocably chosen to withhold and pay tax for a benefit for an employee under the scheme in accordance with subsection (3); or

(b) an employer chooses to withhold and pay tax for a benefit for an employee under the scheme in accordance with subsection (4).

Irrevocable obligation

(2) An employer who has made an irrevocable election described in subsections (1)(a) and (3) must comply with subsection (4)(a) to (c) for—

(a) the relevant benefit and employee under the scheme:

(b) benefits offered or provided to the employee in replacement of the relevant benefit.

Irrevocable obligation: form

(3) For the purposes of subsection (1)(a), an employer has irrevocably chosen to withhold and pay tax for a benefit for an employee, if it is a term of the offer of the benefit, or of the scheme under which the benefit is provided, that the employer must withhold and pay tax under this section.

Withholding and paying

(4) For the purposes of subsection (1)(b), an employer chooses to withhold and pay tax for some benefits for some employees by—

(a) calculating the amounts of tax that must be withheld for the relevant benefits and employees, and paying the amounts to the Commissioner as described in section RD 4(1); and

(b) including the amounts in the employer's employment income information under subpart 3C of the Tax Administration Act 1994, treating the relevant ESS deferral date as the relevant payday; and

(c) making the disclosure referred to in paragraph (b) within the time required under section RD 6(3)(a).

77. Section RD 7B allows an employer to choose to withhold tax on an ESS benefit provided to an employee. An employer can make the election when the benefit is provided by calculating the amount of tax, paying the tax to Inland Revenue and including the amount of the tax in its EI return in the timeframe required.

78. Alternatively, an employer can make an irrevocable election to withhold and pay tax on an ESS benefit at the time the benefit is offered. It makes this election by including in the terms of the offer or the scheme that the employer must withhold and pay tax under s RD 7B. The employer must also comply with the withholding and payment requirements of subs (4) of s RD 7B.[15]

79. If an employer has made an election to withhold tax from a share-settled ESS benefit under s RD 7B, then the benefit is treated as an extra pay under s RD 7(1)(bb). As such, it is a PAYE income payment (s RD 3) and subject to the PAYE rules (s RD 2(2)).

15 The irrevocable election was introduced to enable employers to meet the requirements to adopt equity-settled accounting treatment for the withheld tax under International Financial Reporting Standards. See **Employee share schemes – withholding obligations** *Tax Information Bulletin* Vol 31, No 8 (September 2019): 85.

RD 2 PAYE rules and their application

Meaning

(1) The **PAYE rules** means—

(a) section BC 1 (Non-filing and filing taxpayers); and

(b) sections LA 6, LB 1, and LD 4 (which relate to tax credits); and

(c) sections RD 3 to RD 24; and

(d) sections RP 2 to RP 16 (which relate to PAYE intermediaries); and

(e) subparts 3C and 3D, sections 22AA, 124H to 124K, 124O to 124Q, 133, Part 9, sections 167 to 169, and schedules 4 and 5 of the Tax Administration Act 1994.

Application

(2) The PAYE rules apply to a person who makes or is required to make a PAYE income payment and, in certain circumstances, to the person to whom the PAYE income payment is made.

…

80. Under the PAYE rules, an employer is required to pay the tax withheld to Inland Revenue and report the value of the benefit and the amount of tax withheld in its EI return on the relevant date.

81. If the employer has not made an election to withhold tax from a share-settled ESS benefit, then the benefit is not an extra pay or a PAYE income payment. However, the benefit is still income to the employee under s CE 1(1)(d). Under the PAYE rules, the employer is required to report the value of the benefit to Inland Revenue in its EI return (unless the person is a former employee). A former employee must report the value of the benefit in their tax return themselves. The employee (including if they are a former employee) pays tax on the benefit through the end-of-year tax return process (and through provisional tax if applicable).[16]

Paragraph (bb) – cash-settled benefits

82. On first impression, the election to withhold tax on an ESS benefit could also apply to cash-settled benefits. However, as a cash-settled ESS benefit is already an extra pay under s RD 7(1)(a) (from which an employer is required to withhold tax), this raises the question of how ss RD 7(1)(a), RD 7(1)(bb) and RD 7B interact.

83. Section 10(1) of the Legislation Act 2019 states that "the meaning of legislation must be ascertained from its text and in the light of its purpose and its context".[17] It is therefore useful to consider:

- the structure of the definition of extra pay;
- the history of the introduction of ss RD 7(1)(bb) and RD 7B;
- the broader statutory context; and
- the interaction of ss RD 7(1)(a), RD 7(1)(b) and RD 7B.

The structure of the definition of "extra pay"

84. The structure of the definition of "extra pay" uses the words "means", "includes" and "does not include". In *Northland Environmental Protection Society*, the Supreme Court described this structure as straightforward and conventional with the "includes" part of the structure extending the general definition in certain respects.

> [39] Turning to the wording of the definition of finished or manufactured indigenous timber product, the first point is that this definition has a straight forward and conventional structure. Para (a) contains the general definition. Para (b) extends the definition in certain respects, while para (c) excludes certain categories of items that would otherwise come within paras (a) or (b).

85. Likewise in *Begg v CIR* (2009) 24 NZTC 23,473, the Court of Appeal held (at [18] to [30]) that a definition containing both the words "means" and "includes" enlarges or extends the ordinary meaning of the defined term. This meant that the thing "included" did not need to come within the "means" part of the definition.

16 See **QB 23/05: Provisional tax – impact on salary or wage earners who receive a one-off amount of income without tax deducted** *Tax Information Bulletin* Vol 35, No 5 (June 2023)

17 For more on s 10(1) of the Legislation Act 2019, see IS 23/01: Tax avoidance and the interpretation of the general anti-avoidance provisions sections BG 1 and GA 1 of the Income Tax Act 2007.

86. In *Progressive Meats Ltd v Ministry of Health* [2008] NZCA 162 the Court of Appeal agreed with the District Court judge's approach that the use of the "means" and "includes" technique in that case gave rise to an extended definition of "workplace".

87. The case law shows that the usual approach to a "means" and "includes" definition is to interpret the "includes" part of the definition as extending the "means" part to cover things that would not ordinarily come within it. As s RD 7(1)(b) demonstrates, "includes" is also used to give examples of things that come within the "means" definition without the intention that the examples are exhaustive. While these are the normal uses of "includes" in a "means" and "includes" definition, "includes" may have other effects depending on the context.[18]

88. Section RD 7(1)(bb) extends the definition of extra pay to include ESS benefits **in relation to which** an employer has made an election to withhold tax under s RD 7B. The words "in relation to" express a way in which two things are connected. The *Oxford English Dictionary* defines "relation" as follows:[19]

> **Relation, n. 2. a.** An attribute denoting or concept expressing a connection, correspondence, or contrast between different things; a particular way in which one thing or idea is connected or associated with another or others; a link, a correlation; the fact of being so connected, associated, etc.; connection, association. Frequently with *to*, *between*, or *with*.

89. In the Commissioner's view, the use of the words "in relation to" in para (bb) does not limit the general definition of extra pay in para (a). In the context of the history of the legislation, s RD 7(1)(bb) simply extends the meaning of extra pay to include benefits where the employer has elected to withhold tax. It does not prevent a cash-settled ESS benefit from being an extra pay under s RD 7(1)(a).

90. The question is whether an employer has made an election under s RD 7B. On first impression, the election can apply to both cash- and share-settled benefits. However, an indication that the election is intended to apply only to share-settled benefits can be found in s RD 7B(4)(c), which refers to s RD 6(3)(a). Section RD 6(3)(a) applies when an employee receives the benefit otherwise than in cash.

> **RD 6 Certain benefits and payments**
>
> *When this section applies*
>
> (1) This section applies when an employee receives—
>
> …
>
> (d) a benefit under section CE 1(1)(d) (Amounts derived in connection with employment) in relation to which the employer has made an election under section RD 7B; or
>
> …
>
> *When non-cash benefit treated as paid*
>
> (3) If the employee receives the benefit otherwise than in cash, the value is treated as paid—
>
> (a) for a benefit referred to in subsection (1)(d), on the ESS deferral date on which the employee is treated as deriving the benefit under section CE 2(8) (Benefits under employee share schemes); or
>
> …

91. Section RD 7B proceeds on the basis that there is a **choice** to withhold. Likewise s RD 7(1)(bb) refers to an election. In the Commissioner's view, an employer cannot choose or elect to withhold tax in relation to a cash-settled ESS benefit when withholding is already required (because a cash-settled benefit is an extra pay under s RD 7(1)(a)). The election can only apply to a share-settled benefit.

92. It could be argued that an employer always chooses to withhold tax for a cash-settled ESS benefit and therefore a cash-settled benefit will be an extra pay under both paras (a) and (bb) of s RD 7(1). This argument proceeds on the basis that a cash-settled ESS benefit is an extra pay under s RD 7(1)(a) and so an employer will necessarily meet all the requirements of an election under s RD 7B(4). In the Commissioner's view, this argument is circular in nature and the better view is that an employer has not made (and cannot make) an election under s RD 7B for a cash-settled ESS benefit.

18 Carter at 570

19 *Oxford English Dictionary* (online edition, Oxford University Press 2023, accessed 22 December 2023)

The history of the introduction of ss RD 7(1)(bb) and RD 7B

93. The background and legislative history of the introduction of ss RD 7(1)(bb) and RD 7B show the following:
    - The genesis for the changes was that some employers approached Inland Revenue about using the PAYE system to return tax on their employees' behalf.
    - The officials' issues paper **Simplifying the collection of tax on employee share schemes** (Inland Revenue, April 2015) was only concerned with non-monetary ESS benefits.
    - The overarching purpose of the changes was to **simplify tax compliance** for employees. If an employer withholds tax, then the employee should not have additional tax to pay at the end of the year or become a provisional taxpayer as a result of receiving an ESS benefit.
    - Other reasons for the changes were to reduce the risk of non-compliance and minimise Inland Revenue's administration costs. (It is more efficient for tax to be withheld at source.)
    - Withholding was made elective rather than compulsory because Parliament accepted stakeholders' concerns that compulsory withholding may impose additional compliance costs on employers, meaning that taxing ESS benefits at source was not always appropriate or efficient.[20] These concerns apply to share-settled benefits only.
94. The legislation achieves its main purpose of simplifying compliance for employees (if the employer elects to withhold tax) in relation to share-settled benefits.
95. However, a cash-settled ESS benefit was already (and still is) an extra pay under the general definition of extra pay and subject to tax at source. New legislation was not necessary to allow an employer to withhold tax from a cash-settled benefit. Applying the legislation so that a cash-settled ESS benefit is **only** an extra pay **if** an election is made would be inconsistent with the main purpose of simplifying compliance for employees. It would result in more employees paying tax on the benefit through the end-of-year tax process and potentially becoming provisional taxpayers.
96. The purposes of reducing the risk of non-compliance and minimising Inland Revenue's administrative costs are also achieved for share-settled benefits (where an election is made) but not for cash-settled benefits.
97. Overall, the history of the introduction of the election to withhold PAYE on ESS benefits shows that it was only intended to apply to non-cash benefits.

The broader statutory context

98. Employment income is generally taxed at source, under either the PAYE or FBT rules. It clearly fits within the scheme of the Income Tax Act 2007 (the Act) to withhold tax from share scheme benefits that were not previously subject to tax at source (ie share-settled benefits). However, it would be inconsistent with the scheme of the Act for a cash-settled ESS benefit that was previously subject to tax at source to now only be subject to tax at source at the election of the employer.
99. It is also relevant to the integrity of the tax system and perceptions of fairness if some cash amounts received by employees are subject to tax at source and others are only subject to tax at source at the election of the employer.

The interaction of ss RD 7(1)(a), RD 7(1)(b) and RD 7B

100. A cash-settled ESS benefit is an extra pay under the general definition of extra pay (s RD 7(1)(a)). On first impression, it could also be an extra pay under s RD 7(1)(bb) if an employer has elected to withhold tax.
101. In *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, the Supreme Court stated at [24]:

> Where, as here, the meaning is not clear on the face of the legislation, the court will regard context and purpose as essential guides to meaning.

20 **Taxation (Transformation: First Phase Simplification and Other Measures) Bill (Regulatory Impact Statements, Policy and Strategy**, Inland Revenue, June 2015) at [61]

102. In relation to inconsistent provisions, Carter states at 607–608:

> Normally it will be found, on reading the Act as a whole, taking into account scheme and purpose, that the two provisions can in fact be read consistently, albeit by "reading down" one of them. Often it will be discovered on such a contextual reading that the reader's own first impressions of one section have to be modified.
>
> …
>
> Sometimes the reconciliation requires a strained interpretation to be given to one section; the law has always recognised that the avoidance of internal inconsistency can justify some liberality with words. In some such cases it is necessary to decide, in the light of the scheme and purpose of the legislation, which of the two provisions is the dominant one, requiring the other to be read down. … In determining which of two sections is to have primacy, regard may be had to their purpose, their history, and even their positioning in the Act.

103. Looking at the situation as a whole and considering the purpose of the legislation, the history and the statutory context, the Commissioner considers that s RD 7(1)(bb) extends the definition of extra pay to include share-settled ESS benefits where the employer has elected to withhold tax under s RD 7B. It does not apply to cash-settled ESS benefits that are already an extra pay under s RD 7(1)(a).

Summary

104. The definition of "extra pay" applies to ESS benefits as follows:

- A cash-settled ESS benefit is an extra pay under the general definition of extra pay in s RD 7(1)(a).
- Section RD 7(1)(bb) extends the general definition of extra pay to include a share-settled benefit where the employer has elected to withhold tax.
- An employer cannot (and does not) make an election to withhold tax for a cash-settled ESS benefit.

105. This view is supported by the overarching purpose of the election, which is to simplify tax for employees by allowing an employer to withhold tax at source. It would not be consistent with that purpose if an employer was able to choose not to withhold tax from a benefit where withholding was already required under the Act. This conclusion is also consistent with the scheme of the Act, which is to tax employment income at source.

ACC earners' levy

106. An employer's obligations regarding collecting ACC earners' levy are set out in the Accident Compensation Act 2001 (ACC Act). An issue related to whether an employer is required to withhold tax from a cash-settled benefit under the PAYE rules is whether the earners' levy also applies to cash-settled ESS benefits.

107. An employer collects the earners' levy by making a deduction from an employee's "earnings" (s 221 of the ACC Act). "Earnings" includes "earnings as an employee" (s 6 of the ACC Act). "Earnings as an employee" means all PAYE income payments (as defined in s RD 3(1)) of the person for the tax year (s 9 of the ACC Act).

108. Section 11 of the ACC Act excludes from "earnings as an employee" any benefit arising from an ESS under s CE 2.[21]

> **11 Earnings as an employee: what it does not include**
>
> (1) Earnings as an employee, in relation to any person and any tax year, does not include—
>
> …
>
> (cb) any benefit arising from an employee share scheme under section CE 2 of the Income Tax Act 2007; or
>
> …

109. Because a cash-settled ESS benefit is a PAYE income payment, as a starting point it is subject to ACC earners' levy. However, s 11(1)(cb) applies to exclude a cash-settled ESS benefit from the definition of "earnings as an employee" for ACC purposes. This is because a cash-settled benefit is a benefit arising from an ESS under s CE 2 of the Income Tax Act. As such, an employer is not required to deduct ACC from a cash-settled benefit.

110. For completeness, an employer is not required to deduct ACC earners' levy from a share-settled benefit where an employer has elected to withhold tax under s RD 7B. Such a benefit is a PAYE income payment, but is also excluded from being "earnings as an employee" for ACC purposes under s 11(1)(cb).

21 The exclusion in s 11(1)(cb) was updated to apply to all ESS benefits by the Taxation (Annual Rates for 2024-25, Emergency Response, and Remedial Measures) Act 2025. A similar exclusion applies for shareholder-employees in s 15 of the ACC Act.

111. In summary, an employer is not required to deduct ACC earners' levy from a cash-settled ESS benefit. This outcome arises because a cash-settled ESS benefit is excluded from the definition of "earnings as an employee" under the ACC Act.

Summary

112. A cash-settled ESS benefit is an extra pay and a PAYE income payment. As such, an employer is required to withhold an amount of tax from the payment under the PAYE rules at the appropriate extra pay rate. ACC earners' levy does not apply to a cash-settled ESS benefit.

Is an employer required to deduct student loan repayments from a cash-settled ESS benefit?

113. The Student Loan Scheme Act 2011 (SLS Act) sets out an employer's obligations for collecting student loan repayments under ss 36 and 37.

114. An employer collects student loan repayments by making a deduction from an employee's "salary or wages", which includes an "extra pay" under the SLS Act.[22] The definition of "salary or wages" in the SLS Act does not exclude an ESS benefit.

115. A cash-settled ESS benefit is an extra pay under s RD 7(1)(a). Accordingly, an employer is required to deduct student loan repayments from an ESS benefit.

116. For completeness, an employer is required to deduct student loan repayments in relation to a share-settled benefit where the employer has elected to withhold tax. In this situation the share-settled benefit is treated as an extra pay under s RD 7(1)(bb).

117. In summary, an employer is required to deduct student loan from a cash-settled ESS benefit. This outcome arises because a cash-settled ESS benefit is an extra pay from which a student loan deduction is required under the SLS Act.

What are an employer's KiwiSaver obligations for a cash-settled employee share scheme benefit?

118. An employer's KiwiSaver obligations are determined under the KiwiSaver Act 2006 (KiwiSaver Act).

119. Broadly, if an employee is a KiwiSaver member and is not on a savings suspension (ie taking a break from making KiwiSaver contributions), then an employer is required to deduct KiwiSaver contributions at the relevant contribution rate from the employee's gross salary or wages.[23] An employer is also generally required to make a compulsory employer contribution based on an employee's gross salary or wages.[24]

120. "Salary or wages" is defined in s 4 of the KiwiSaver Act and relevantly states:

> **salary or wages**, in relation to any person, means salary or wages as defined in section RD 5(1)(a) to (c) of the Income Tax Act 2007 (whether the salary or wages are primary or secondary employment earnings) except that, in this Act,—
>
> (a) it excludes—
>
> …
>
> (vi) the amount of a benefit that an employee receives under section CE 2 of the Income Tax Act 2007 under an employee share scheme when the amount is treated as an amount of extra pay of the employee:
>
> (b) it includes extra pay (as defined in section YA 1 of the Income Tax Act 2007), unless—
>
> (i) otherwise excluded under paragraph (a) of this definition; or
>
> (ii) the amount is a redundancy payment for the purposes of the Income Tax Act 2007.

INTERPRETATION STATEMENTS

22 Section 4 ("salary or wages").

23 See Part 3, subpart 1 (Deductions of contributions from salary or wages) of the KiwiSaver Act.

24 See Part 3, subpart 3A (Compulsory employer contributions to KiwiSaver schemes and complying superannuation funds) of the KiwiSaver Act.

121. As a starting point, "salary or wages" for KiwiSaver purposes means salary or wages as defined in s RD 5(1)(a) to (c), which relevantly states:

> **RD 5 Salary or wages**
>
> *Meaning*
>
> **(1) Salary or wages—**
>
> (a) means a payment of salary, wages, or allowances made to a person in connection with their employment; and
>
> (b) includes—
>
> …
>
> (c) does not include—
>
> …
>
> (ii) an extra pay:
>
> …

122. "Salary or wages" in s RD 5 does not include an extra pay (s RD 5(1)(c)(ii)). In contrast, para (b) of the definition of "salary or wages" in the KiwiSaver Act includes an extra pay in salary or wages for the purposes of that Act. But it does not include an extra pay that is otherwise excluded from being "salary or wages" under para (a). Paragraph (a)(vi) excludes:

> the amount of a benefit that an employee receives under section CE 2 of the Income Tax Act 2007 under an employee share scheme when the amount is treated as an amount of extra pay of the employee:

123. A cash-settled ESS benefit is a benefit that an employee receives under s CE 2 of the Income Tax Act and it is treated as an amount of extra pay under s RD 7(1)(a). Therefore, a cash-settled ESS benefit is excluded from the definition of salary or wages for KiwiSaver purposes. As such, an employer is not required to make deductions or employer contributions in relation to a cash-settled ESS benefit.

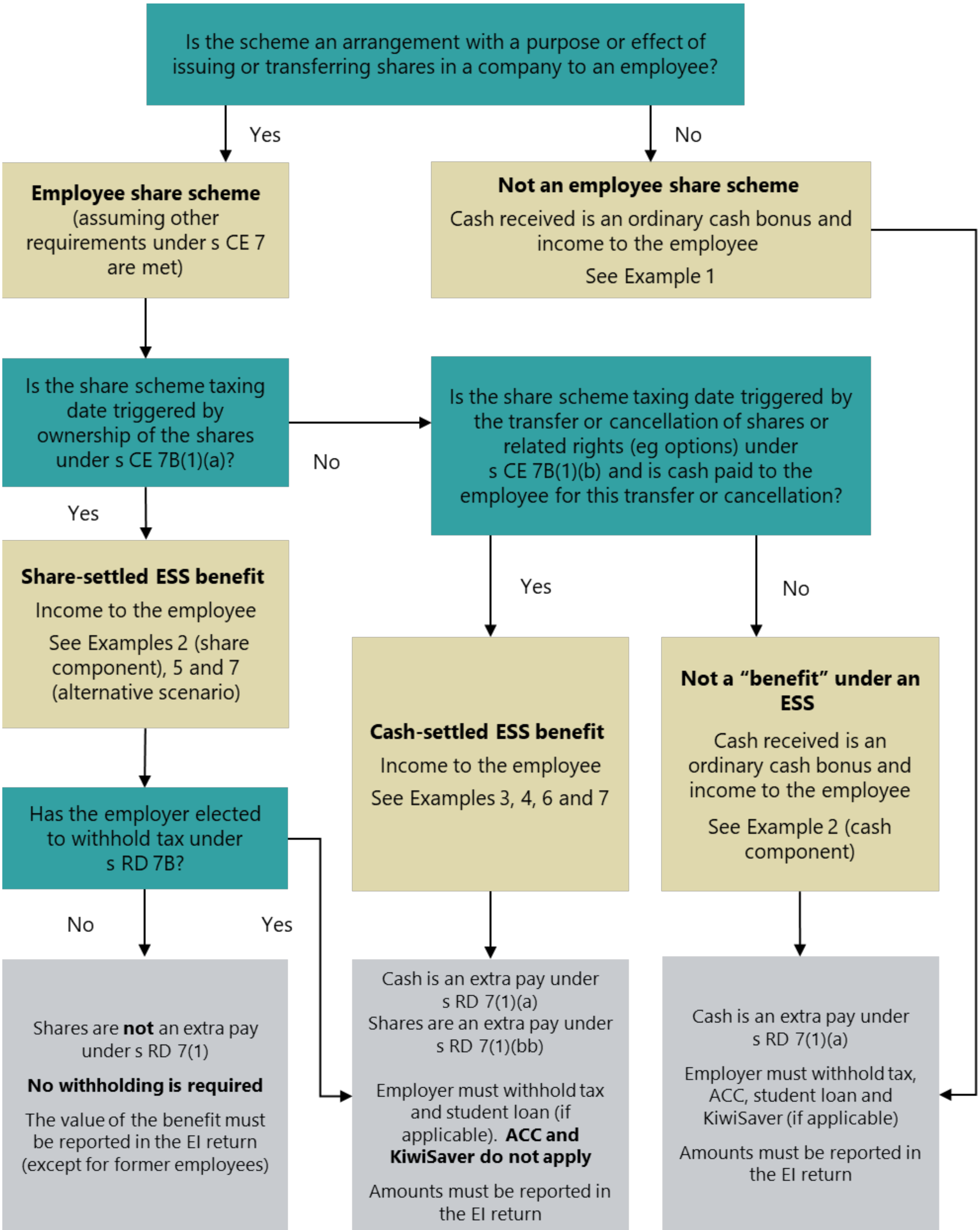
124. For completeness, an employer is not required to make KiwiSaver deductions or employer contributions in relation to a share-settled benefit where the employer has elected to withhold tax. In this situation the share-settled benefit is treated as an extra pay under s RD 7(1)(bb) and is excluded from the definition of salary or wages for KiwiSaver purposes.

125. In summary, an employer is not required to make KiwiSaver deductions or employer contributions in relation to a cash-settled ESS benefit. This outcome arises because KiwiSaver deductions and contributions are based on an employee's gross salary or wages and a cash-settled ESS benefit is excluded from the definition of "salary or wages" for the purposes of the KiwiSaver Act.

Overall summary

126. Figure | Hoahoa 1 sets out the key questions relevant to determining an employer's PAYE, student loan and KiwiSaver obligations for awards provided to an employee under a share scheme (including a phantom share scheme). It only considers awards provided to an employee under a share scheme – it does not consider other payments made as part of the arrangement such as a bonus to repay a loan used to purchase shares.

Figure | Hoahoa 1: Key questions to determine employer obligations for awards provided to an employee under a share scheme



Examples | Tauira

Example | Tauira 1 – Phantom share scheme

After a successful performance review, Ellen receives a letter from her employer Garments Ltd inviting her to participate in the company's employee share plan. The letter grants her 1,000 Restricted Stock Units (RSUs). The market value of Garments' shares is $10 on grant date. The RSUs will vest after 3 years. Ellen does not pay anything for the RSUs. Ellen will forfeit the RSUs if she leaves Garments within 3 years of the grant date.

The letter and the share plan rules state the RSUs are virtual shares that conditionally entitle Ellen to receive a cash payout corresponding to the value of a real share on the vesting date. The RSUs do not entitle Ellen to ownership of Garments' shares, voting rights or dividend payments.

Ellen continues to be an employee of Garments and the RSUs vest 3 years after the grant date. The market value of Garments' shares on the vesting date is $50. Ellen receives a payment of $50,000 in the month after the RSUs vest.

Although the arrangement mimics an ESS, the fact that the RSUs are virtual, and Ellen receives a cash payout and is not entitled to become a shareholder under the plan, means that the plan is **not an "employee share scheme"** for tax purposes. The arrangement does not have "a purpose or effect of issuing or transferring shares" in a company to an employee.

The payment is a cash bonus or extra pay and is income to Ellen under s CE 1(1)(a). It is an extra pay under s RD 7(1)(a) and a PAYE income payment. Garments Ltd will have the usual PAYE (including ACC), student loan and KiwiSaver obligations.

Example | Tauira 2 – Incentive scheme involving a combination of cash and shares

Jaya, an employee of Research Ltd, receives an award letter advising that she is eligible to participate in the company's incentive scheme. The incentive scheme has both a cash and a share component.

Jaya's maximum incentive under the scheme is $50,000. She will receive this as 50% cash and 50% shares, to the extent that she meets specific performance goals for the financial year.

Jaya meets all of her performance goals and receives $25,000 cash and $25,000 of Research Ltd's shares.

The arrangement is an "employee share scheme". It is connected to Jaya's employment and it has **a** purpose or effect of transferring shares in Research Ltd to Jaya. At the time the arrangement is entered into, an objective effect of the arrangement is to transfer cash and shares to Jaya, so there is **a** purpose of transferring shares.

The shares Jaya receives are a benefit under an ESS. The share scheme taxing date for the share component is triggered by share ownership under s CE 7B(1)(a). The value of the benefit calculated under s CE 2(1) is $25,000 (ie the market value of the shares on the share scheme taxing date). The value of the **share-settled benefit** is income to Jaya under s CE 1(1)(d). Research Ltd can choose whether to withhold tax on the value of the benefit under ss RD 7(1)(bb) and RD 7B. If it chooses to withhold tax, student loan deductions will also apply (if any). ACC and KiwiSaver do not apply to ESS benefits. No matter whether Research Ltd withholds tax or not, it must report the value of the benefit in its EI return.

The cash payment does not give rise to a "benefit" under an ESS. This is because the cash component does not trigger the share scheme taxing date under s CE 7B(1); it does not provide share ownership and it is not paid in relation to a transfer or cancellation of shares or related rights under the scheme. Accordingly, it does not give rise to a benefit under s CE 2(1). The cash is paid in satisfaction of the right to cash granted to Jaya.

The cash payment is still income to Jaya under s CE 1(1)(a) as a bonus or extra pay. The cash payment will be an extra pay under s RD 7(1)(a) and a PAYE income payment. As it is a PAYE income payment, Research Ltd will have the usual PAYE (including ACC), student loan and KiwiSaver obligations. The exemptions for ACC and KiwiSaver do not apply because the payment is not a benefit under an ESS.

Example | Tauira 3 – Option scheme, employer reserves the right to pay cash

Rawiri is employed by Gumboots Ltd. On 30 March 2017 Gumboots Ltd grants Rawiri options to buy 1,000 shares in Gumboots Ltd. The exercise price is $1 per option, which is the market value of the shares on grant date. Rawiri has 10 years to exercise the options. If Rawiri exercises the options, company management reserves the right to cancel the options and pay Rawiri the cash equivalent (ie the market value of the shares at the time less the exercise price).

The options are provided in relation to Rawiri's employment with Gumboots Ltd. Rawiri will forfeit the options if he ceases employment within 3 years of the date of grant.

Rawiri stays employed for 3 years and the options vest. Five years later Rawiri decides to exercise his options and gives the required notification to Gumboots Ltd. The market value of the shares at that time is $25. Gumboots Ltd exercises its right to cancel the options and pays Rawiri the cash equivalent (ie $24,000).

The arrangement is an "employee share scheme". It is connected to Rawiri's employment and it has **a** purpose or effect of transferring shares in the company to Rawiri even though Gumboots Ltd can choose to cancel the options and pay Rawiri the cash equivalent. At the time the arrangement is entered into, an objective effect of the arrangement is to transfer cash or shares to Rawiri, so there is **a** purpose of transferring shares.

In this situation the share scheme taxing date is triggered by the cancellation of the options under s CE 7B(1)(b).

The payment gives rise to a benefit under s CE 2(1). The amount of the benefit is the amount of consideration paid to Rawiri in relation to the cancellation of the share options under the ESS (ie $24,000).

The amount of the benefit is income to Rawiri under s CE 1(1)(d). As Rawiri received cash (and not shares), the payment is **a cash-settled ESS benefit**.

A cash-settled ESS benefit is an extra pay under s CE 7(1)(a) and a PAYE income payment. Gumboots Ltd must deduct tax (and student loan, if any). ACC earners' levy and KiwiSaver do not apply.

Example | Tauira 4 – Option scheme, employee chooses to receive cash

Marie is employed by Travel Ltd, a publicly listed company. Travel Ltd grants Marie options to buy 1,000 shares in Travel Ltd. The exercise price is $1 per option, which is the market value of the shares on grant date. The options will vest the following year if the company meets its financial targets and Marie remains employed by Travel Ltd. Marie will have 3 years to exercise the options. Alternatively, she can choose to receive a cash equivalent during the 3-year exercise period. If Marie chooses to take cash, Travel Ltd will cancel the options in return for a cash payment equal to the market value of the shares at the time less the exercise price. It is the company's preference that employees exercise the options rather than take cash because the objective of the scheme is to incentivise employees through company ownership. The company offers a cash payout alternative for those employees who do not wish to own shares.

The company meets its financial targets, Marie remains employed and the options vest. Two years later, Marie decides to take a cash payout. The market value of the shares at that time is $10 per share. Marie receives a cash payment of $9,000.

The arrangement is an "employee share scheme". It is connected to Marie's employment and it has **a** purpose or effect of transferring shares in the company to Marie even though Marie can choose to receive cash instead of shares. At the time the arrangement is entered into, an objective effect of the arrangement is to transfer shares to Marie, so there is **a** purpose of transferring shares.

In this situation the share scheme taxing date is triggered by the cancellation of the options under s CE 7B(1)(b).

The payment gives rise to a benefit under s CE 2(1). The amount of the benefit is the amount of consideration paid to Marie in relation to the cancellation of the share options under the ESS (ie $9,000).

The amount of the benefit is income to Marie under s CE 1(1)(d). As Marie received cash (and not shares), the payment is **a cash-settled ESS benefit**.

A cash-settled ESS benefit is an extra pay under s CE 7(1)(a) and a PAYE income payment. Travel Ltd must deduct tax (and student loan, if any). ACC earners' levy and KiwiSaver do not apply.

Example | Tauira 5 – Sale of company, share-settled benefit

Steve is a key employee of Tech Ltd, a privately owned company. Tech Ltd invites Steve to participate in the company incentive scheme. Steve is granted options to purchase 100,000 shares in Tech Ltd. The exercise price is $1 per share, which is the fair market value of the shares on grant date. The options will vest in 4 years if Steve is still an employee of Tech Ltd. If Steve leaves the company, any options that have not vested will be forfeited. Steve has 5 years from the vesting date to exercise the options.

The terms of the scheme state that if the company is sold to a third party, vesting will be accelerated and occur on the date of the sale, and Steve will be required to exercise his options and then sell and transfer all of his shares to the purchaser. Tech Ltd will receive the purchase price of the shares, deduct the exercise price and pay the balance to Steve.

Three years after Steve is granted the options, Tech Ltd is sold to an unrelated third party for $3 per share (which is market value). On the date of the sale, Steve's options vest, he exercises them, the shares are issued and then sold and transferred to the purchaser. Tech Ltd pays Steve the purchase price less the exercise price.

The scheme is an "employee share scheme". It is an arrangement with a purpose or effect of issuing or transferring shares in Tech Ltd to Steve and the arrangement is connected to Steve's employment.

In this situation, the share scheme taxing date is triggered by the issue of the shares to Steve under s CE 7B(1)(a) and therefore it is a **share-settled benefit**.

The value of the benefit calculated under s CE 2(1) is $200,000 (ie the market value of the shares on the date they are issued to Steve less the exercise price).

The amount of the benefit is income to Steve under s CE 1(1)(d). Tech Ltd can choose whether to withhold tax from the benefit under ss RD 7(1)(bb) and RD 7B. If Tech Ltd chooses to withhold tax it must also deduct student loan repayments (if any) but ACC earners' levy and KiwiSaver do not apply.

If Tech Ltd does not choose to withhold tax, Tech Ltd is still required to report the value of the benefit in its EI return on the relevant date.

Example | Tauira 6 – Sale of company, cash-settled benefit

The facts are the same as in Example | Tauira 6 except that, instead of specifying that Tech Ltd issues shares to Steve and then immediately sells them to the purchaser, the terms of the scheme state that if the company is sold to a third party, vesting will be accelerated and the vested options will be cancelled in return for a cash payment equivalent to the sale price of the shares less the exercise price.

Three years after Steve is granted the options, Tech Ltd is sold to an unrelated third party for market value. The vesting of Steve's options is accelerated and the unexercised options are cancelled in return for a cash payment equal to the market value of the shares less the exercise price.

In this situation, the share scheme taxing date is triggered by the cancellation of the options under s CE 7B(1)(b).

The payment gives rise to a benefit under s CE 2(1). The amount of the benefit is the amount of consideration paid to Steve in relation to the cancellation of the share options under the ESS.

The amount of the benefit is income to Steve under s CE 1(1)(d). As Steve received cash (and not shares), the payment is **a cash-settled ESS benefit**.

A cash-settled ESS benefit is an extra pay under s CE 7(1)(a) and a PAYE income payment. Tech Ltd must deduct tax (and student loan, if any). ACC earners' levy and KiwiSaver do not apply.

Example | Tauira 7 – Employee retires

Billie is a senior executive at Sneakers Ltd. She has been participating in Sneakers Ltd's long term incentive plan (LTI) for the past five years. Under the plan, every year, Billie is granted a right to acquire 1,000 shares in Sneakers Ltd at no cost. The rights vest after three years if certain performance hurdles are met by the company at the end of the vesting period (which aligns with the end of the company's financial year on 31 March).

If Billie leaves the company for any reason other than redundancy or retirement, any unvested rights are forfeited. If Billie is made redundant or retires, any unvested rights will be cancelled but she will be entitled to a cash payment in relation to the cancelled rights under a formula in the plan.

Billie retires on 31 December 2023. Under the terms of the plan the board determines the amount of the cash payment that Billie will receive for the cancellation of the unvested rights and makes that payment to Billie.

The payment is a **cash-settled ESS benefit** (ie it is a benefit received under an ESS that is provided in cash rather than shares). This outcome arises because:

- The LTI is an "employee share scheme". It is an arrangement with a purpose or effect of issuing or transferring shares in Sneakers Ltd to Billie and the arrangement is connected to Billie's employment.
- The share scheme taxing date is triggered by the cancellation of rights under s CE 7B(1)(b).
- A cash payment is made to Billie for the cancellation of the unvested rights and the payment gives rise to a benefit under s CE 2(1).

The amount of the benefit is income to Billie under s CE 1(1)(d).

A cash-settled ESS benefit is an extra pay under s CE 7(1)(a) and a PAYE income payment. Sneakers Ltd must deduct tax (and student loan, if any). ACC earners' levy and KiwiSaver do not apply.

Alternative scenario

On retirement, the terms of the plan allow Billie to remain in the plan to the extent she still has rights under the plan. No new rights are granted. Under the plan there is a formula to determine how many of the unvested rights are eligible to vest (based on the number of days Billie was with the company during the vesting period). Any remaining rights are forfeited. If the performance hurdles are met Billie will receive shares in the company on the usual dates.

In this situation, if the performance hurdles are met Billie will receive a **share-settled benefit**. This outcome arises because the share scheme taxing date is triggered by share ownership under s CE 7B(1)(a). The market value of the shares on the share scheme taxing date will give rise to a benefit under s CE 2(1).

Billie will be a former employee when any shares vest. This means Sneakers Ltd will not be required to report the value of the benefit in its EI return (unless it elects to withhold tax). However, the benefit will be taxable income to Billie under s CE 1(1)(d) and she will be required to include the value of the benefit in her tax return.

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Taxation (Transformation: First Phase Simplification and Other Measures) Bill (Regulatory Impact Statements, Policy and Strategy, Inland Revenue, June 2015) **taxpolicy.ird.govt.nz/publications/2015/2015-ris-tfpsom-bill**

IS 25/07: PAYE – How an employer funds the tax cost on an employee share scheme benefit

Issued | Tukuna: 31 March 2025

This interpretation statement explains an employer's withholding and reporting obligations related to PAYE, student loans and KiwiSaver if an employer wants to fund the cost of tax (and student loan, if applicable) on an employee share scheme benefit provided in shares.

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

REPLACES | WHAKAKAPIA

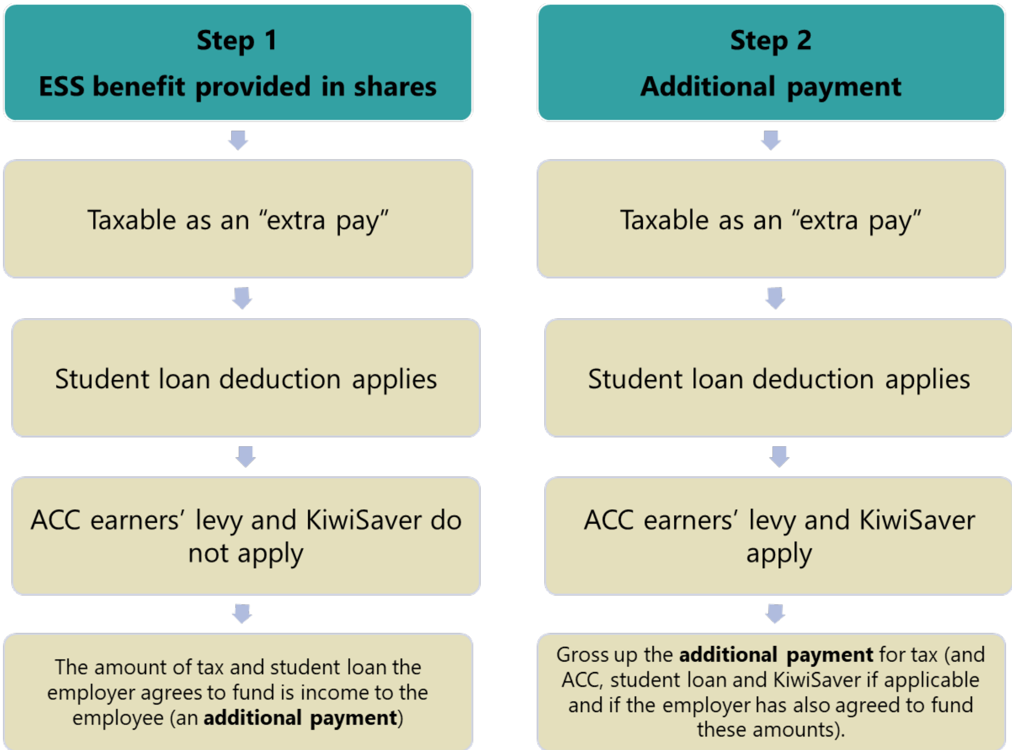
- This interpretation statement updates and replaces **IS 24/06: PAYE – How an employer funds the tax cost on an employee share scheme benefit** for the amendments to s 11(1)(cb) of the Accident Compensation Act 2001 by the Taxation (Annual Rates for 2024-25, Emergency Response, and Remedial Measures) Act 2025.

Summary | Whakarāpopoto

1. This interpretation statement explains an employer's PAYE, student loan and KiwiSaver obligations where an employer wants to fund the cost of tax on an employee share scheme (ESS) benefit provided in **shares**.
2. It is unlikely that an employer would fund the cost of tax on an ESS benefit provided in cash. For this reason, this interpretation statement does not consider that situation.
3. An ESS benefit is income to an employee. Where an employer provides the benefit in shares (ie a non-cash benefit), it is not required to withhold tax from the benefit and in that case the employee pays tax on the benefit through the end-of-year tax return process.
4. To simplify the end-of-year tax return process for the employee, an employer might choose to withhold tax from the ESS benefit under the PAYE rules. When an employer chooses to withhold tax from an ESS benefit that it provides in shares, the benefit in shares is treated as an "extra pay" and a PAYE income payment from which the employer is required to withhold tax at the relevant extra pay tax rate. If the employee has a student loan, the employer may need to make a student loan deduction. Accident Compensation Corporation (ACC) earners' levy and KiwiSaver deductions (and contributions) do not apply to ESS benefits.
5. As the ESS benefit is in shares and a non-cash benefit, the tax withheld will need to be funded in some way. If the employer has not agreed to fund the tax payment, it will need to be funded by the employee. For example, the employer and employee may agree that, to fund the tax the employer will deduct it from the employee's net salary or sell a portion of the shares on behalf of the employee.
6. Alternatively, the employer may agree to fund the tax (and any student loan deduction, if applicable) on the ESS benefit. The additional payment that an employer makes to fund the cost of the tax on an ESS benefit (and a student loan deduction, if applicable) is itself an "extra pay". As an extra pay, it is income to the employee and a PAYE income payment from which the employer is required to withhold tax at the relevant extra pay tax rate.
7. The employer may also be required to withhold ACC earners' levy and make student loan and KiwiSaver deductions (and contributions) in relation to the additional payment. The exclusions from ACC earners' levy and KiwiSaver deductions (and contributions) that apply to the ESS benefit do not apply to the additional payment because the additional payment is not itself an ESS benefit for tax purposes. The employer will need to consider whether it wants to fund the cost of ACC earners' levy and KiwiSaver deductions on the additional payment.
8. If the employer wants to ensure that the employee does not have to fund the cost of the tax (or other deductions) on the ESS benefit and the additional payment, it must gross up any additional payment it makes for any resulting tax, student loan, ACC earners' levy and KiwiSaver. This outcome arises because the employer is providing the employee with a further benefit (the additional payment) that is assessable income to the employee. As a result, further tax (and student loan, if applicable) is payable, and ACC earner's levy and KiwiSaver deductions (and contributions) may also apply to the additional payment.

9. Figure | Hoahoa 1 illustrates these obligations.

Figure | Hoahoa 1: Summary of the tax consequences when an employer elects to withhold tax from an ESS benefit provided in shares and agrees to fund the cost of the tax (and potentially other deductions).



10. If an employer wants to fund only the tax (and ACC earners' levy, if applicable) and not student loan or KiwiSaver deductions (if any), then it should inform the employee that the employer will need to make a deduction from the employee's net salary or wages to cover the student loan and KiwiSaver deductions.

11. To the extent that an employer is required to separately identify the amount of the ESS benefit in its employment income information, this amount should not include an additional payment made to fund tax (and student loan deduction, if applicable) on the ESS benefit. An additional payment of this nature is not part of the ESS benefit for tax purposes.

12. Examples illustrating the points discussed in this interpretation statement follow from [72].

Introduction | Whakataki

Background

13. Generally, where an employee receives a benefit under an employee share scheme (ESS), their employer provides it in **shares** (ie it is a non-cash benefit). The amount of the benefit is income to the employee and the employee pays tax on the benefit through the end-of-year tax return process (and through provisional tax, if applicable).[1] See Example | Tauira 1.

14. An employer is not required to withhold tax on an ESS benefit provided in shares. However, an employer can choose to withhold tax under the PAYE rules. Withholding tax simplifies the end-of-year tax process for the employee.

15. If an employer decides to withhold tax, it also needs to think about how that tax will be paid given that shares are a non-cash benefit. Specifically, it needs to consider whether it will be the employee or the employer that funds the payment of the tax.

16. If it is intended that the employee should bear the cost of the withholding, the employer and the employee will need to agree how the tax will be paid. Possible alternatives include the employer deducting the tax from the employee's salary or selling a portion of the shares on behalf of the employee.

1 For more information about how receiving an ESS benefit that is not taxed at source affects an employee, see **QB 23/05: Provisional tax – impact on salary or wage earners who receive a one-off amount of income without tax deducted** *Tax Information Bulletin* Vol 35, No 5 (June 2023).

17. In some situations, an employer may want to fund the payment of the tax. It might do this so that the employee does not have to sell shares or fund the payment of the tax from their usual net salary. Ultimately whether the employer or the employee funds the tax will depend on what they agree between them.
18. In some circumstances, an employer provides an ESS benefit in cash.[2] In this situation, the PAYE rules require an employer to withhold tax. As the employer pays the benefit in cash, it would generally deduct tax from the payment under the PAYE rules in the usual way. As it is unlikely an employer would fund the payment of tax where it provides the ESS benefit in cash, this interpretation statement does not consider that situation.
19. Where an employer elects to withhold tax from an ESS benefit it provides in shares, it is also required to make a student loan deduction, if applicable. If the employee has a student loan, then the employer will need to consider whether it will fund the cost of the student loan deduction or whether the employee will fund this cost.
20. KiwiSaver and Accident Compensation Corporation (ACC) earners' levy do not apply to ESS benefits. However, where the employer bears the cost of tax (and student loan deduction, if applicable) on an ESS benefit, KiwiSaver and ACC earners' levy may apply to that additional payment.
21. This interpretation statement explains an employer's withholding and reporting obligations related to PAYE, student loans and KiwiSaver where an employer:
    - has elected to withhold tax in relation to an ESS benefit provided in **shares**; and
    - has agreed to fund the cost of the tax (and potentially other obligations).
22. While this statement is focused on the situation where an employer agrees to fund the cost of the tax, an example of the situation where an employer has elected to withhold but has not agreed to fund the cost of the tax can be found at Example | Tauira 3.

What this statement covers

23. For ease of reference, this statement uses **additional payment** to mean the amount of tax (and student loan deduction, if applicable) that the employer funds on an ESS benefit.
24. This statement covers:
    - the nature of the additional payment;
    - an employer's PAYE, student loan and KiwiSaver obligations;
    - when an employer must gross up the additional payment;
    - how an employer calculates a gross up;
    - an employer's obligations in reporting the additional payment; and
    - examples illustrating the points discussed.
25. Generally, a child support deduction notice will not apply to an ESS benefit or an additional payment to fund the tax (and student loan, if any) on the ESS benefit. However, if an employer has any questions about whether to make a child support deduction, they should contact Inland Revenue. This statement does not consider child support deductions any further.

Analysis | Tātari

The nature of the additional payment

26. When considering an employer's PAYE, student loan and KiwiSaver obligations in the situation where an employer is funding the tax (and student loan deduction, if applicable) on an ESS benefit, it is necessary to understand the nature of what the employer is providing to the employee.
27. An ESS benefit is income to an employee under s CE 1(1)(d). Where the benefit is in shares and the employer has elected to withhold tax under s RD 7B, then the benefit is treated as an "extra pay" under s RD 7(1)(bb).

2 For more information on ESS benefits provided in cash, see **IS 25/06: Employer obligations for employee share scheme benefits paid in cash**.

28. An "extra pay" (s RD 7) and "salary or wages" (s RD 5) are payments made to a person in connection with their employment. Salary or wages are generally regular amounts, and an extra pay is generally a one-off amount. They are both "PAYE income payments" from which an employer is required to withhold tax under ss RA 5 and RD 3. They are defined separately because the amount of tax withheld from an extra pay is calculated differently to PAYE on salary or wages.

29. Where an employer is funding the tax payable on an ESS benefit (and student loan deduction, if applicable), then the question is whether this additional payment is also:

- income to the employee; and
- a PAYE income payment from which an employer is required to withhold tax.

30. Employment income is defined in s CE 1 and includes an "extra pay" under s CE 1(1)(a) and an employee share scheme benefit under s CE 1(1)(d).

> **CE 1 Amounts derived in connection with employment**
>
> *Income*
>
> (1) The following amounts derived by a person in connection with their employment or service are income of the person:
>
> (a) salary or wages or an allowance, bonus, extra pay, or gratuity:
>
> …
>
> (d) a benefit received under an employee share scheme:
>
> …

31. Section RD 7(1)(a) contains the general definition of an "extra pay".

> **RD 7 Extra pay**
>
> *Meaning*
>
> (1) An **extra pay**—
>
> (a) means a payment that—
>
> (i) is made to a person in connection with their employment; and
>
> (ii) is not a payment regularly included in salary or wages payable to the person for a pay period; and
>
> (iii) is not overtime pay; and
>
> (iv) is made in 1 lump sum or in 2 or more instalments; and
>
> …
>
> (d) does not include a payment of exempt income.
>
> …

32. The additional payment the employer makes meets the requirements of s RD 7(1)(a). It is a payment made to a person (which is then applied to their tax and student loan accounts) and it is made in connection with their employment (it relates to an ESS benefit). As a one-off payment, it is not a payment regularly included in the employee's salary or wages and is generally made in one lump sum. It is not overtime pay. It is unlikely to be a payment of exempt income (see subparts CW and CZ for exempt income provisions).

33. Accordingly, the additional payment is an "extra pay" as defined in s RD 7(1)(a). As an "extra pay", it is income to the employee under s CE 1(1)(a) and a PAYE income payment from which an employer must withhold tax under ss RA 5 and RD 3.

34. It is important to note that the additional payment is not part of the ESS benefit for tax purposes. For tax purposes, the amount of the ESS benefit is determined under s CE 2(1) and (2).

CE 2 Benefits under employee share schemes

Benefit

(1) A person who is an employee share scheme beneficiary described in section CE 7(a)(i) or (ii) receives a benefit for the purposes of section CE 1(1)(d) in relation to shares or related rights under the employee share scheme equal to the positive amount calculated on the share scheme taxing date using the formula—

share value − consideration paid + consideration received − previous income.

Definition of items in formula

(2) In the formula in subsection (1),—

(a) **share value** is the market value of the shares or related rights owned by an employee share scheme beneficiary on the share scheme taxing date, if the share scheme taxing date is not triggered by a transfer or cancellation of the shares or related rights:

(b) **consideration paid** is the amount of consideration paid or payable by an employee share scheme beneficiary in relation to the transfer of the shares or related rights under the employee share scheme:

(c) **consideration received** is the amount of consideration paid or payable to an employee share scheme beneficiary in relation to a transfer or cancellation of the shares or related rights under the employee share scheme, not including relevant shares or related rights under a replacement employee share scheme:

(d) **previous income** is the total amount of income under section CE 1(1)(d) that the employee share scheme beneficiary has in relation to the shares or related rights before the date that is 6 months after the date of Royal assent for the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018.

…

35. Broadly, when an employee receives an ESS benefit in shares, the amount of the benefit is the market value of the shares on the share scheme taxing date less the amount paid for the shares (if anything).

36. The additional payment to fund the tax on the ESS benefit (and student loan deduction, if applicable) is not part of the "share value" and neither is it "consideration received". "Consideration received" deals with amounts paid for the transfer or cancellation of shares or related rights held by an employee under an ESS when the share scheme taxing date is triggered by the transfer or cancellation of the shares or related rights (rather than the ownership of shares).

37. The fact that the additional payment is not part of the ESS benefit for tax purposes means that any special rules that apply to an ESS benefit generally do not apply to the additional payment. For further discussion of the impact of this conclusion, see [46] in relation to ACC earners' levy and [55] on KiwiSaver.

An employer's PAYE, student loan and KiwiSaver obligations

38. This section considers an employer's obligations to deduct PAYE (including ACC earners' levy), student loan repayments and KiwiSaver from:

- an ESS benefit where the employer has elected to withhold tax; and
- an additional payment an employer makes to fund the tax on the ESS benefit.

Income tax

39. As discussed at [27], when an employer elects to withhold tax from an ESS benefit, then the benefit is treated as an "extra pay" and a PAYE income payment from which an employer is required to withhold tax.

40. Likewise, as concluded at [33], an additional payment that an employer makes to fund the tax (and student loan deduction, if applicable) on an ESS benefit is also an "extra pay" and a PAYE income payment from which an employer is required to withhold tax.

41. Tax on the ESS benefit and the additional payment is calculated at the employee's extra pay tax rate. The extra pay tax rate is generally determined under s RD 17 and sch 2, part B. Broadly, an employee's extra pay tax rate is the marginal tax rate based on the sum of the employee's annualised salary and the amount of the extra pay. In some circumstances an employee can choose to have an extra pay taxed at a marginal tax rate higher than the one calculated by their employer under s RD 17 (s RD 10).

42. More information about calculating tax on an extra pay is available in the current Weekly and fortnightly PAYE deduction tables – **IR340**, Four-weekly and monthly PAYE deduction tables – **IR341**, the Employer's Guide – **IR 335**, in *Tax Information Bulletin* **Vol 36 No 4 (May 2024)**: 131 and on our website – **Calculate PAYE for a lump sum payment**.

ACC earners' levy

43. The Accident Compensation Act 2001 (ACC Act) sets out an employer's obligations for collecting ACC earners' levy.

44. An employer collects ACC earners' levy by making a deduction from an employee's "earnings" (s 221, ACC Act). "Earnings" include "earnings as an employee", which means all PAYE income payments (as defined in s RD 3(1)) of the person for the tax year (ss 6 and 9, ACC Act). Section 11 of the ACC Act then excludes from "earnings as an employee" any benefit arising from an ESS under s CE 2 of the Income Tax Act.

45. Accordingly, an employer is not required to deduct ACC earners' levy from an ESS benefit that it provides in shares because the benefit is excluded from being "earnings" for the purposes of the ACC Act.

46. However, as discussed from [34] to [37], the additional payment made to fund the cost of the tax (and student loan deduction, if applicable) on an ESS benefit is not itself an ESS benefit. Therefore, it will be "earnings" for the purposes of the ACC Act (as it is not otherwise excluded). This means that an employer will be required to deduct ACC earners' levy from the additional payment (unless, broadly, the sum of the employee's annualised salary and the additional payment is higher than the maximum amount of income that ACC earners' levy is charged on). ACC earners' levy rates and maximum earnings thresholds can be found on our website – **ACC earners' levy rates**.

Student loan

47. The Student Loan Scheme Act 2011 (SLS Act) sets out an employer's obligations for collecting student loan repayments under ss 36 and 37.

48. An employer collects student loan repayments by making a deduction from an employee's "salary or wages", which includes an "extra pay" under the SLS Act.[3] The definition of "salary or wages" in the SLS Act does not exclude an ESS benefit.

49. Accordingly, an employer is required to deduct student loan repayments from an ESS benefit and any additional payment.

50. As discussed at [19], where an employer wants to fund the tax on an ESS benefit provided in shares (ie a non-cash benefit) and the employee has a student loan, then the employer needs to consider whether it also wants to fund the cost of the student loan deduction. If the employer does not agree to fund the student loan deduction, the employee must fund it (eg the employee may agree to the employer deducting the amount from their salary, or the employee may pay the student loan amount out of their net salary).

KiwiSaver

51. The KiwiSaver Act 2006 (KiwiSaver Act) sets out an employer's KiwiSaver obligations.

52. Broadly, if an employee is a KiwiSaver member and is not on a savings suspension (ie is not taking a break from making KiwiSaver contributions), then their employer is required to deduct KiwiSaver at the employee's contribution rate from the employee's gross salary or wages. An employer is also generally required to make a compulsory employer contribution based on an employee's gross salary or wages.

53. Section 4 of the KiwiSaver Act defines "salary or wages". It relevantly states:

> **salary or wages**, in relation to any person, means salary or wages as defined in section RD 5(1)(a) to (c) of the Income Tax Act 2007 (whether the salary or wages are primary or secondary employment earnings) except that, in this Act,—
>
> (a) it excludes—
>
> …
>
> (vi) the amount of a benefit that an employee receives under section CE 2 of the Income Tax Act 2007 under an employee share scheme when the amount is treated as an amount of extra pay of the employee:
>
> (b) it includes extra pay (as defined in section YA 1 of the Income Tax Act 2007), unless—
>
> (i) otherwise excluded under paragraph (a) of this definition; or
>
> (ii) the amount is a redundancy payment for the purposes of the Income Tax Act 2007.

3 Section 4 ("salary or wages").

54. It follows that an employer is not required to make KiwiSaver deductions or employer contributions in relation to an ESS benefit. This is because KiwiSaver deductions and contributions are based on an employee's gross salary or wages and an ESS benefit is expressly excluded from the definition of "salary or wages" in s 4 of the KiwiSaver Act.

55. However, as discussed from [34] to [37], any additional payment made to fund the cost of the tax (and student loan deduction, if applicable) on the ESS benefit is not itself an ESS benefit. Therefore, any additional payment made to fund the cost of tax (and student loan deduction, if applicable) on the ESS benefit will be "salary or wages" for the purposes of the KiwiSaver Act. This means that an employer may be required to make KiwiSaver deductions from or employer contributions on the additional payment.

Summary

56. When an employer elects to withhold tax from an ESS benefit provided in shares, the ESS benefit is treated as an "extra pay" from which the employer is required to withhold tax at the relevant extra pay tax rate. The employer may also be required to make a student loan deduction. ACC earners' levy and KiwiSaver deductions (and contributions) do not apply to the ESS benefit.

57. Any additional payment that the employer makes to fund the tax (and student loan deduction, if applicable) on the ESS benefit is also an "extra pay" from which the employer is required to withhold tax at the relevant extra pay tax rate. The employer may also be required to withhold ACC earners' levy and make student loan and KiwiSaver deductions (and contributions) in relation to the additional payment. The exclusions from ACC earners' levy and KiwiSaver that apply to the ESS benefit do not apply to the additional payment because the additional payment is not itself an ESS benefit for tax purposes.

58. When an employer wants to fund the tax on an ESS benefit, the employer will also need to consider whether it wants to fund the cost of any student loan deduction on the ESS benefit and the cost of ACC earners' levy, student loan and KiwiSaver deductions on the additional payment. If it does not, it will need to seek reimbursement of those amounts from the employee.

When an employer must gross up the additional payment

59. Whether an employer is required to gross up an additional payment depends on what has been agreed between the employer and the employee.

60. Where an **employer** has agreed to make a payment to fund the tax and any other deductions (ie ACC earners' levy, student loan and KiwiSaver) associated with the delivery of an ESS benefit to an employee, then the amount of the tax (and student loan deduction, if any) on the ESS benefit will be an additional payment to the employee. The employer must gross up that additional payment for PAYE (and student loan and KiwiSaver deductions, if any). This outcome arises because the employer is providing the employee with a further benefit (the tax and student loan payments) that is assessable income to the employee. As a result, further tax (and ACC earners' levy, student loan and KiwiSaver, if applicable) is payable. See Example | Tauira 2 and Example | Tauira 7.

61. Where an employer has agreed to fund only the PAYE on the ESS benefit and the additional payment (not student loan or KiwiSaver) then the amount of the additional payment is the amount of tax on the ESS benefit. The employer must gross up the additional payment for tax (and ACC earners' levy if applicable). Any student loan deduction on the ESS benefit and the additional payment and any KiwiSaver deduction on the additional payment would need to be funded by the employee. See Example | Tauira 6 and Example | Tauira 8.

62. The employer need not gross up if the **employee** is funding the cost of the tax on the ESS benefit. For example, this applies if the employer deducts the tax from the employee's net salary or sells a portion of the shares on the employee's behalf to fund the tax. In this case, the employee is not receiving any additional benefit from the employer and so no additional tax is payable. See Example | Tauira 3.

How an employer calculates a gross-up

63. The first step is for the employer to work out the amount of the additional payment. This amount will generally be the total of:

- the tax on the ESS benefit at the appropriate extra pay tax rate; and
- the amount of the student loan deduction on the ESS benefit (if applicable and if the employer has also agreed to fund this amount).

64. The next step is for the employer to "gross up" **the additional payment** for tax (and ACC earners' levy, student loan and KiwiSaver deductions, if applicable and if the employer has also agreed to fund these amounts).

65. Some payroll software allows an employer to gross up the additional payment for the applicable amounts. However, in situations where an employer must calculate the value manually, it may use the following gross-up formula:

Gross income = net income / (1 – tax rate)

66. The "net income" is the amount of the additional payment calculated at step 1 (see [63]). The "tax rate" (where an employer is funding the tax on an ESS benefit) is the appropriate extra pay tax rate for the employee. This is because the tax funded by the employer is a one-off amount and an "extra pay" under s RD 7 (see [29] to [33]). If the employer is funding more than one tax type (or deduction), such as a student loan as well as the tax on an ESS benefit, then it adds the tax rates together. See Example | Tauira 4, Example | Tauira 5 and Example | Tauira 7.

67. If an employer wants to fund only the tax (and ACC earners' levy, if applicable) and not student loan or KiwiSaver deductions (if any), then it should inform the employee that it will need to make a deduction from the employee's net salary or wages to cover any student loan and KiwiSaver deductions on the ESS benefit and the additional payment as applicable. See Example | Tauira 6 and Example | Tauira 8.

An employer's reporting obligations

68. Section RD 22 requires an employer (or PAYE intermediary) to provide employment income information to the Commissioner.

69. Where an employer is required to separately identify the amount of the ESS benefit, this amount should not include an additional payment made to fund tax (and student loan deduction, if applicable) on the ESS benefit. As discussed from [34] to [36], an additional payment of this nature is not part of the ESS benefit for tax purposes.

70. On the basis that the date the employer makes the additional payment is likely to be the same date the ESS benefit is processed through payroll, then there should be no difference in the reporting date for the ESS benefit and the additional payment.

71. More information about an employer's reporting obligations for an ESS benefit is on our website - **Filing employment information about ESS benefits**.

Examples | Tauira

72. The following examples illustrate the points discussed in this interpretation statement. All the examples use an extra pay tax rate of 33% and a KiwiSaver employee contribution rate of 6% (for KiwiSaver members) for ease of comparison but different rates may apply for different employees.

Example | Tauira 1 – No election to withhold tax

Joe receives some shares under an ESS from his employer, Legacy Ltd. He does not pay anything for the shares. The value of the ESS benefit is $10,000. The terms of the scheme state that no tax will be withheld from the ESS benefit (unless required by law) and that the payment of tax on the ESS benefit is Joe's responsibility.

Joe has a student loan and is a KiwiSaver member. Joe is not currently a provisional taxpayer.

Legacy Ltd reports the following amounts to Inland Revenue in its employment information (together with Joe's usual salary information, if applicable):

Employee share scheme earnings	$10,000
Earnings not liable for ACC earners' levy	$10,000

KiwiSaver does not apply to an ESS benefit.

Joe pays tax on the ESS benefit through the end-of-year tax return process. As Joe's tax to pay is not more than $5,000 (all his other income is taxed at source) Joe will not be a provisional taxpayer.

The ESS benefit may have implications for Joe's end-of-year student loan repayment obligations and requirements to make interim student loan repayments.

Other scenarios

If the value of the ESS benefit was higher and Joe had more than $5,000 tax to pay, he would need to consider provisional tax implications for the following year.

If the value of the ESS benefit was higher and Joe had $60,000 or more of tax to pay in the current year, Joe may be exposed to use-of-money interest.

Example | Tauira 2 – Employer funds the tax

Marie receives some shares under an ESS from her employer, Steady Ltd. She does not pay anything for the shares. The value of the ESS benefit is $10,000. The terms of the scheme state that Steady Ltd will withhold tax from the ESS benefit and fund the payment of the tax.

Marie does not have a student loan and is not a KiwiSaver member. Her annual salary is higher than the maximum liable earnings for ACC earners' levy.

Steady Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Marie of 33% ($10,000 × 33% = $3,300).

Steady Ltd must gross up the amount of $3,300. This is because Steady Ltd is providing Marie with a further benefit (the tax payment) that is an "extra pay" and assessable income to Marie. As a result, further tax is payable. Steady Ltd calculates the gross-up as follows:

Gross income =	$3,300.00 / (1 – 0.33)
	$3,300.00 / 0.67
	$4,925.37

Steady Ltd makes a payment of $4,925.37 to Marie in its payroll system and withholds tax of $1,625.37 at 33% ($4,925.37 × 33% = $1,625.37). The net amount of $3,300 is not paid to Marie's bank account, instead Steady Ltd makes a deduction for that amount and pays it to Inland Revenue as the tax on the ESS benefit.

Steady Ltd reports the following amounts to Inland Revenue in its employment information (together with Marie's usual salary information, if applicable):

Gross earnings	$4,925.00
Employee share scheme earnings	$10,000.00
Earnings not liable for ACC earners' levy	$10,000.00
PAYE deductions	$4,925.37 ($3,300 + $1,625.37)

The additional payment of $4,925.37 that Steady Ltd makes to Marie in its payroll system is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes. For reporting purposes, ESS earnings have their own separate field and are not included in the gross earnings field.

Other scenarios

If Steady Ltd had processed the ESS benefit of $10,000 through its payroll system and paid the tax of $3,300 for Marie without doing anything further, this would have been incorrect. The payroll system would show income of $10,000 and tax of $3,300, leaving a net amount of $6,700. This outcome is incorrect because Marie actually received a net amount of $10,000.

If Steady Ltd had limited its additional payment to $3,300, this amount would still be income to Marie and subject to tax. Steady Ltd must report the $3,300 as additional income to Marie. As Steady Ltd would only be funding the tax on the ESS benefit and not on the additional payment, Marie would need to fund the tax on the additional payment. For example, that tax could be deducted from her net salary or wages.

Example | Tauira 3 – Employee funds the tax

Nate receives some shares under an ESS from his employer, Rapid Ltd. He does not pay anything for the shares. The value of the ESS benefit is $10,000. The terms of the scheme state that Rapid Ltd will elect to withhold tax from the benefit and that Nate can choose whether to fund the tax through a deduction from his net salary or the sale of a portion of the shares.

Nate does not have a student loan and is not a KiwiSaver member. His annual salary is $156,000 which is higher than the maximum liable earnings for ACC earners' levy.

Nate chooses to fund the tax through a deduction from his net salary which he agrees to in writing. Rapid Ltd calculates the tax on the ESS benefit using the appropriate extra pay tax rate for Nate of 33%. The result is as follows:

ESS benefit	$10,000
Tax at 33%	$3,300
Net income	$6,700

Although Nate has received $10,000 worth of shares, Rapid Ltd has deducted $3,300 from his usual net salary payment. Therefore, Nate has received a net benefit of $6,700. Nate's payslip for his next fortnightly salary payment shows:

Payments	
Salary	$6,000.00
Deductions	
PAYE	$1,718.32
Tax on ESS benefit	$3,300.00
Net amount	$981.68

If Nate had chosen to sell a portion of his shares to fund the tax, Rapid Ltd would have sold $3,300 worth of shares on Nate's behalf and Nate would have received $6,700 worth of Rapid Ltd shares. The overall outcome would be the same: that is, the value of the ESS benefit would be $10,000 and Nate would receive a net benefit of $6,700.

The employer need not gross up in either of these situations because the employee is funding the cost of the tax.

Rapid Ltd reports the following amounts to Inland Revenue in its employment information (regardless of whether the tax is funded by a deduction from Nate's usual net salary or the sale of shares).

Gross earnings	$6,000.00
Employee share scheme earnings	$10,000.00
Earnings not liable for ACC earners' levy	$10,000.00
PAYE deductions	$5,018.32 ($3,300 + $1,718.32)

For reporting purposes, ESS earnings have their own separate field and are not included in the gross earnings field.

Other scenarios

If Nate had a student loan, the student loan deduction on his ESS benefit would also need to be deducted from his usual net salary payment (or more shares would need to be sold to fund the student loan repayment).

If Nate was a KiwiSaver member there would be no impact on the above calculation as KiwiSaver does not apply to an ESS benefit and Rapid Ltd is not funding the cost of the tax so there is no additional payment made to Nate.

Example | Tauira 4 – Employer funds tax and ACC earners' levy

Olivia receives some shares under an ESS from her employer, Steady Ltd. She does not pay anything for the shares. The value of the ESS benefit is $10,000. The terms of the scheme state that Steady Ltd will withhold tax from the ESS benefit and fund the payment of the tax.

Olivia's annual salary is below the maximum liable earnings for ACC earners' levy. She does not have a student loan and is not a KiwiSaver member.

Steady Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Olivia of 33% ($10,000 × 33% = $3,300). ACC earners' levy does not apply to an ESS benefit.

Steady Ltd must gross up the amount of $3,300. This is because Steady Ltd is providing Olivia with a further benefit (the tax payment) that is an "extra pay" and assessable income to Olivia. As a result, further tax is payable. Olivia's annualised income plus the amount of the extra pay is below the maximum liable earnings for ACC earners' levy therefore ACC earners' levy at 1.60% applies to the whole of the additional payment. Steady Ltd calculates the gross-up as follows:

Gross income =	$3,300.00 / (1 – (0.33 + 0.016))
	$3,300.00 / (1 – 0.346)
	$3,300.00 / 0.654
	$5,045.87

Steady Ltd makes a payment of $5,045.87 to Olivia in its payroll system and withholds PAYE of $1,745.87 at 34.6% ($5,045.87 × 34.6% = $1,745.87). The net amount of $3,300 is not paid to Olivia's bank account, instead Steady Ltd makes a deduction for that amount and pays it to Inland Revenue as the tax on the ESS benefit.

Steady Ltd reports the following amounts to Inland Revenue in its employment information (together with Olivia's usual salary information, if applicable):

Gross earnings	$5,045.00
Employee share scheme earnings	$10,000.00
Earnings not liable for ACC earners' levy	$10,000.00
PAYE deductions	$5,045.87 ($3,300 + $1,745.87)

The additional payment of $5,045.87 that Steady Ltd makes to Olivia in its payroll system is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes. For reporting purposes, ESS earnings have their own separate field and are not included in the gross earnings field.

Example | Tauira 5 – Employer funds tax and student loan deduction

Paora receives some shares under an ESS from his employer, Steady Ltd. He does not pay anything for the shares. The value of the ESS benefit is $10,000. The terms of the scheme state that Steady Ltd will withhold tax from the ESS benefit and fund the payment of the tax and any standard student loan deduction.

Paora has a student loan and uses an SL tax code. He is not a KiwiSaver member. His annual salary is higher than the maximum liable earnings for ACC earners' levy.

Steady Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Paora of 33% ($10,000 × 33% = $3,300). It calculates the student loan deduction on the ESS benefit to be $1,200 using the standard student loan deduction rate of 12%. The total amount funded by Steady Ltd is $4,500.

Steady Ltd must gross up the amount of $4,500. This is because Steady Ltd is providing Paora with a further benefit (the tax and student loan payments) that is an "extra pay" and assessable income to Paora. As a result, further tax is payable and further student loan deductions are required. Steady Ltd calculates the gross-up as follows:

Gross income =	$4,500.00 / (1 – (0.33 + 0.12))
	$4,500.00 / (1 – 0.45)
	$4,500.00 / 0.55
	$8,181.82

Steady Ltd makes a payment of $8,181.82 to Paora in its payroll system and withholds tax of $2,700 at 33% and deducts student loan of $981.82 at 12%. The net amount of $4,500 is not paid to Paora's bank account, instead Steady Ltd makes deductions for $3,300 (tax on the ESS benefit) and $1,200 (student loan on the ESS benefit) and pays these amounts to Inland Revenue.

Steady Ltd reports the following amounts to Inland Revenue in its employment information (together with Paora's usual salary information, if applicable):

Gross earnings	$8,181.00
Employee share scheme earnings	$10,000.00
Earnings not liable for ACC earners' levy	$10,000.00
PAYE deductions	$6,000.00 ($3,300 + $2,700)
Student loan deductions	$2,181.82 ($1,200 + $981.82)

The additional payment of $8,181.82 that Steady Ltd makes to Paora in its payroll system is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes. For reporting purposes, ESS earnings have their own separate field and are not included in the gross earnings field.

Example | Tauira 6 – Employer funds tax but not student loan deduction

Quinn receives some shares under an ESS from her employer, BigCo Ltd. She does not pay anything for the shares. The value of the ESS benefit is $10,000.

The terms of the scheme state that BigCo Ltd will withhold tax from the ESS benefit and fund the payment of the tax but will not fund the payment of any student loan deduction. The employee must fund the cost of any student loan deduction on the ESS benefit and this amount will be deducted from the employee's usual net salary.

Quinn has a student loan and uses an SL tax code. She is not a KiwiSaver member. Her annual salary is $156,000 which is higher than the maximum liable earnings for ACC earners' levy.

BigCo Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Quinn of 33% ($10,000 × 33% = $3,300). The student loan deduction on the ESS benefit is $1,200 (12%).

BigCo Ltd must gross up the amount of $3,300. This is because BigCo Ltd is providing Quinn with a further benefit (the tax payment) that is an "extra pay" and assessable income to Quinn. As a result, further tax is payable. BigCo Ltd calculates the gross-up as follows:

Gross income =	$3,300.00 / (1 – 0.33)
	$3,300.00 / 0.67
	$4,925.37

BigCo Ltd makes a payment of $4,925.37 to Quinn in its payroll system and withholds tax of $1,625.37. The net amount of $3,300 is not paid to Quinn's bank account, instead Steady Ltd makes a deduction for that amount and pays it to Inland Revenue as the tax on the ESS benefit.

Quinn must fund student loan repayments on the ESS benefit of $1,200 and on the additional payment of $591.04 ($4,925.37 × 12% = $591.04). Quinn agrees in writing that Big Co Ltd should deduct these amounts from her next net salary payment. Quinn's payslip for her next fortnightly salary payment shows:

Payments	
Salary	$6,000.00
Deductions	
PAYE	$1,718.32
Student loan	$608.64
Student loan on ESS benefit and grossed-up additional payment	$1,791.04
Net amount	$1,882.00

BigCo Ltd reports the following amounts to Inland Revenue in its employment information:

Gross earnings	$10,925.00 ($4,925.37 + $6,000)
Employee share scheme earnings	$10,000.00
Earnings not liable for ACC earners' levy	$10,000.00
PAYE deductions	$6,643.69 ($3,300 + $1,625.37 + $1,718.32)
Student loan deductions	$2,399.68 ($1,200 + $591.04 + $608.64)

The additional payment of $4,925.37 that BigCo Ltd makes to Quinn in its payroll system is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes. For reporting purposes, ESS earnings have their own separate field and are not included in the gross earnings field.

Example | Tauira 7 – Employer funds tax, student loan and KiwiSaver

Shoko receives some shares under an ESS from her employer, Steady Ltd. She does not pay anything for the shares. The value of the ESS benefit is $10,000.

The terms of the scheme state that Steady Ltd will withhold tax from the ESS benefit and fund the payment of the tax and any standard student loan deduction. Steady Ltd has also agreed to fund any KiwiSaver deduction that applies.

Shoko has a student loan and uses an SL tax code. She is also a KiwiSaver member and her contribution rate is 6%. Her employer's contribution rate is 3% and the employer superannuation contribution tax (ESCT) rate is 33%. Shoko's annual salary is higher than the maximum liable earnings for ACC earners' levy.

Steady Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Shoko of 33% ($10,000 × 33% = $3,300). It calculates the student loan deduction on the ESS benefit to be $1,200 using the standard student loan deduction rate of 12%. The total amount funded by Steady Ltd is $4,500.

Steady Ltd must gross up the amount of $4,500. This is because Steady Ltd is providing Shoko with a further benefit (the tax and student loan payments) that is an "extra pay" and assessable income to Shoko. As a result, further tax is payable and further student loan deductions are required. KiwiSaver deductions (and employer contributions) also apply to the additional payment. Steady Ltd calculates the gross-up as follows:

Gross income =	$4,500.00 / (1 – (0.33 + 0.12 + 0.06))
	$4,500.00 / (1 – 0.51)
	$4,500.00 / 0.49
	$9,183.67

The gross amount is income to Shoko and is applied as follows:

Tax on ESS benefit at 33%	$3,300.00
Tax on grossed-up additional pay at 33%	$3,030.61
SL on ESS benefit at 12%	$1,200.00
SL on additional pay at 12%	1,102.04
KS on additional pay at 6%	551.02
	$9,183.67

None of the additional payment is paid to Shoko's bank account, instead Steady Ltd makes the deductions described in the table above and pays those amounts to Inland Revenue.

Steady Ltd is also required to make a KiwiSaver employer contribution (and withhold ESCT) on the additional payment of $9,183.67. The employer contribution is $275.51 ($9,183.67 x 3%). ESCT is $90.75 ($275 x 33%).

Steady Ltd reports the amounts in the table below in its employment information (together with Shoko's usual salary information, if applicable).

Gross earnings	$9,183.00
Employee share scheme earnings	$10,000.00
Earnings not liable for ACC earners' levy	$10,000.00
PAYE deductions	$6,330.61 ($3,300 + $3,030.61)
Student loan deductions	$2,302.04 ($1,200 + $1,102.04)
KiwiSaver employee deductions	$551.02
Net KiwiSaver employer contribution	$184.76
Employer superannuation contribution tax	$90.75

The additional payment of $9,183.67 that Steady Ltd makes to Shoko in its payroll system is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes. For reporting purposes, ESS earnings have their own separate field and are not included in the gross earnings field.

Example | Tauira 8 – Employer funds tax but not KiwiSaver

Robert receives some shares under an ESS from his employer, Cars Ltd. He does not pay anything for the shares. The value of the ESS benefit is $10,000.

The terms of the scheme state that Cars Ltd will withhold tax from the ESS benefit and fund the payment of the tax but will not fund the payment of any KiwiSaver deduction that applies. The employee must fund the cost of any KiwiSaver deduction and this amount will be deducted from the employee's usual net salary.

Robert is a KiwiSaver member and his contribution rate is 6%. His employer's contribution rate is 3% and the ESCT rate is 33%. Robert does not have a student loan. His annual salary is $156,000 which is higher than the maximum liable earnings for ACC earners' levy.

Cars Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Robert of 33% ($10,000 × 33% = $3,300).

Cars Ltd must gross up the amount of $3,300. This is because Cars Ltd is providing Robert with a further benefit (the tax payment) that is an "extra pay" and assessable income to Robert. As a result, further tax is payable. KiwiSaver deductions (and employer contributions) also apply to the additional payment. However, the additional payment is not required to be grossed up for KiwiSaver as Robert is funding the KiwiSaver employee deduction. Cars Ltd calculates the gross-up as follows:

Gross income =	$3,300.00 / (1 – 0.33)
	$3,300.00 / 0.67
	$4,925.37

Cars Ltd makes a payment of $4,925.37 to Robert in its payroll system and withholds tax of $1,625.37 at 33% ($4,925.37 × 33% = $1,625.37). The net amount of $3,300 is not paid to Robert's bank account, instead Steady Ltd makes a deduction for that amount and pays it to Inland Revenue as the tax on the ESS benefit.

Robert must fund the KiwiSaver deduction on the additional payment of $295.52 ($4,925.37 × 6% = $295.52). Robert agrees in writing that Cars Ltd should deduct this amount from his next net salary payment. Robert's payslip for his next fortnightly salary payment shows:

Payments	
Salary	$6,000.00
Deductions	
PAYE	$1,718.32
KiwiSaver employee contribution	360.00
KiwiSaver employee contribution on grossed-up additional payment	$295.52
Net amount	$3,626.16

Cars Ltd is also required to make a KiwiSaver employer contribution (and withhold ESCT) on the additional payment of $4,925.37. The employer contribution is $147.76 ($4,925.37 x 3%). ESCT is $48.51 ($147 x 33%).

Cars Ltd reports the amounts in the table below in its employment information.

Gross earnings	$10,925.00 ($4,925.37 + $6,000)
Employee share scheme earnings	$10,000.00
Earnings not liable for ACC earners' levy	$10,000.00
PAYE deductions	$6,643.69 ($3,300 + $1,625.37 + $1,718.32)
KiwiSaver employee deductions	$655.52 ($295.52 + $360)
Net KiwiSaver employer contributions	$99.25
Employer superannuation contribution tax	$48.51

The additional payment of $4,925.37 that Cars Ltd makes to Robert in its payroll system is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes. For reporting purposes, ESS earnings have their own separate field and are not included in the gross earnings field.

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IS 25/08: Income tax – implications of a residential property moving between the standard tax rules and the mixed-use asset rules

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This interpretation statement considers situations where a person's use of their residential property has changed so the property moves from being under one set of income tax deduction rules to another. It explains how a person determines which income tax deduction rules apply and the consequences of moving between the standard tax rules and the mixed-use asset rules.

All legislative references are to the Income Tax Act 2007.

Summary | Whakarāpopoto

1. This interpretation statement explains how a person determines:
   - which income tax deduction rules apply to their residential property when its use has changed from the prior income year;
   - the effect of a change in income tax deduction rules on a person's ability to use prior year quarantined expenditure under the mixed-use asset rules;
   - the effect of a change in income tax deduction rules on a person's ability to claim prior year unused excess deductions under the residential property ring-fencing rules; and
   - how the depreciation rules apply to depreciable property used in a residential property when there has been a change in which set of income tax deduction rules apply to the property.
2. This statement applies to persons who derive income from their residential property. This statement does not apply to residential property owned by companies (including close companies).

Income tax deduction rules

3. If a person derives income from a residential property, they must determine whether the mixed-use asset rules or the standard tax rules apply to that property. If the use of a residential property changes from one income year to the next, or within an income year, the set of income tax deduction rules that applies to the residential property may be different from the set of rules that applied in previous income years.
4. The set of rules that applies determines the deductible proportion of the person's expenses. The person must consider which income tax deduction rules apply each income year because the mixed-use asset and residential property ring-fencing rules apply on an income year basis.
5. A person must apply the mixed-use asset rules if, during the income year, the residential property was:
   - partly used to earn income;
   - partly used for private use; and
   - unused for at least 62 days.
6. If the residential property is not a mixed-use asset, the standard tax rules apply. In addition, a person must consider if the residential property is subject to the residential property ring-fencing rules.

Amount of deduction may be limited

7. The amount of the deduction a person can claim relating to their residential property may be limited.
8. If the mixed-use asset rules apply, the amount of the person's deduction is apportioned in the current income year for the private use of the residential property. Further, the amount of the deduction that can be claimed in the income year may be limited under the mixed-use asset quarantined expenditure rules.
9. A person cannot offset any expenditure incurred in a prior income year that has been quarantined under the mixed-use asset rules if the residential property is not a mixed-use asset in the current income year. If the person has not sold the residential property, they can carry forward the quarantined expenditure to future income years.
10. If the standard tax rules apply, a person must consider whether the residential property ring-fencing rules limit the amount of the deduction that can be claimed in the income year. The residential property ring-fencing rules do not apply if one of the specific exclusions applies (for example, the main home exclusion or the mixed-use asset exclusion).

11. A person cannot offset any unused excess deductions carried forward from a prior income year under the residential property ring-fencing rules if their residential property is not subject to the residential property ring-fencing rules in the current income year. However, a person can carry forward the unused excess deductions to future income years.

Calculating depreciation deductions

12. A person can claim depreciation deductions in relation to depreciable property that they use to derive income from their residential property.
13. The first step to calculate a deprecation deduction is for a person to calculate their depreciation loss for the income year for each item of depreciable property. The next step is to work out what proportion of the depreciation loss the person can claim as a deduction in the income year.
14. The proportion of the depreciation loss that is deductible depends on which income tax deduction rules apply to the residential property in the income year and whether the depreciable property is wholly or partly used to produce income.
15. If the mixed-use asset rules apply to the residential property in a given income year, the person must use the apportionment formula in s DG 9 to calculate their depreciation deduction. Further, part of the depreciation deduction may be suspended if the quarantined expenditure rules apply.
16. If the standard tax rules apply and the depreciable property is wholly used to produce income, the depreciation deduction is the depreciation loss amount. However, if the depreciable property is only partly used to produce income, the person must apportion the depreciation loss. In addition, if the residential property ring-fencing rules apply, the person may need to suspend a portion of the depreciation deduction and carry it forward to a future income year.
17. Any apportionment of the depreciation loss under either the standard tax rules or the mixed-use asset rules does not change how a person calculates the depreciation loss in future income years. The calculation for the depreciation loss is based on the depreciable property's adjusted tax value, which takes into account the total depreciable loss a person could have claimed before any apportionment or suspension.

Disposal of depreciable property

18. When a person sells an item of depreciable property, they must calculate their depreciation recovery income or depreciation loss on sale. The method for calculating depreciation recovery income or depreciation loss on sale is the same whether the standard tax rules or mixed-use asset rules apply to the residential property.
19. A person cannot offset any prior-year mixed-use asset quarantined expenditure against depreciation recovery income. Depreciation recovery income is not asset income (that is, income derived from the use of the mixed-use asset).
20. If the residential property ring-fencing rules apply to the residential property in the income year an item of depreciable property is sold, a person can offset unused excess deductions against depreciation recovery income they derive on the sale of the item of depreciable property. However, if the residential property ring-fencing rules do not apply in the income year of sale, a person cannot offset unused excess deductions against depreciation recovery income.

Introduction | Whakataki

21. If a person derives rental income from a residential property, they must work out which income tax deduction rules apply so they can meet their tax obligations.
22. Depending on a person's circumstances, the residential property will fall under either the mixed-use asset rules or the standard tax rules. The set of rules that applies determines the deductible proportion of the person's expenses and how any unused deductions can be used in future income years.
23. A person also needs to consider whether they can claim depreciation deductions for the use of items of depreciable property used in conjunction with the residential property. How the rules apply can become complicated when a person has calculated depreciation deductions under the mixed-use asset rules in one income year and under the standard tax rules in the next income year, or the other way around.

24. This interpretation statement provides guidance for persons who derive income from residential property and the use of that residential property changes. This interpretation statement is organised into four parts:
    - **Part one** – explains how a person determines which income tax deduction rules apply to their residential property.
    - **Part two** – discusses when a person can use prior-year expenditure that has been quarantined under the mixed-use asset rules, or unused excess deductions carried forward from a prior income year under the residential property ring-fencing rules.
    - **Part three** – discusses how to apportion the depreciation loss and calculate the depreciation deduction when the residential property moves from being under one set of income tax deduction rules to another.
    - **Part four** – explains how to calculate depreciation recovery income or depreciation loss on sale on the disposal of depreciable property.

Part one – Determining which income tax deduction rules apply

25. If a person derives rental income from a residential property, they must determine whether the mixed-use asset rules or the standard tax rules apply.
26. If the use of the residential property changes in an income year, the income tax deduction rules the person must apply to the property for that income year may differ from the set of rules they applied to it in the previous income year.
27. A person must revisit which income tax deduction rules apply each income year, as the mixed-use asset rules apply on an income-year basis. A person must keep records to work out at the end of each income year which rules apply and to be able to apply the relevant rules correctly.
28. **Figure | Hoahoa 1** will help a person determine which set of income tax deduction rules applies to their circumstances in any given income year.

Mixed-use asset rules

29. The mixed-use asset rules apply where assets are sometimes used privately, sometimes used to earn income and are also unused for at least 62 days during the income year. The mixed-use asset rules apply on an asset-by-asset basis. Residential property is within the scope of the mixed-use asset rules.
30. If the mixed-use asset rules apply, a person must use those rules to apportion their expenditure between the income earning use of the residential property and its private use. In addition, if the residential property is loss making, the person must determine whether any of their deduction is quarantined expenditure.

Asset criteria

31. Residential property is a "mixed-use asset" if, during the income year it (s DG 3):
    - is partly used to earn income;
    - is partly used privately; and
    - was not used for at least 62 days.
32. Private use includes use by persons associated with the owner and use by persons renting it for "mates' rates" – that is, rates that are less than 80% of the market value rent (s DG 4). Further, it is not necessary for the private use to be exclusive use of the residential property for the mixed-use asset rules to apply.
33. If the residential property meets the criteria for a mixed-use asset, the owner must consider whether any of the exclusions to the mixed-use asset rules apply.
34. The mixed-use asset rules will not apply to residential property if its only income-earning use in the income year is as a long-term rental property (s DG 3(4)(c)).
35. A person can opt out of the mixed-use asset rules if (s DG 21):
    - their income for the income year from the residential property is under $4,000;[1] or
    - they made a loss from the residential property and if they did not opt out of the rules would have quarantined expenditure (that is, expenditure carried forward to the next income year).

1 The $4,000 threshold does not include income that is classed as exempt income. Exempt income is income from renting out the dwelling to associated persons (for example, family members) or income from renting out the dwelling for less than 80% of the market value rent.

36. If a person chooses to opt out of the mixed-use asset rules, the income from the residential property is exempt. This means the person does not pay tax on the income and they cannot claim tax deductions for any expenditure or loss relating to the residential property.

37. For further information on opting out of the mixed-use asset rules, see **QB 25/02**: **Income tax – Which rules apply if I have a dwelling I sometimes rent out as short-stay accommodation and also sometimes uses privately?**

Apportionment of expenditure

38. If the residential property is a mixed-use asset, deductions can be claimed for expenses that relate solely to its rental activity. Any expenses that relate solely to the private use of the residential property are not deductible.

39. Expenses that relate to both the income-earning and private use of the residential property will be only partly deductible. The person must use the formula in s DG 9(2) to calculate the deductible portion of this expenditure:

expenditure × income-earning days ÷ (income-earning days + counted days)

where:

- "expenditure" is the expenditure that relates to both the income-earning and private use of the residential property;
- "income-earning days" are the total number of days in the income year that the person derived income (other than exempt income) from the use of the mixed-use asset; and
- "counted days" are the total number of days in the income year the asset was in use, excluding income-earning days.

40. The effect of the formula is that the proportion of expenses that is deductible reflects the income-earning use of the mixed-use asset relative to the private use.

41. For an explanation of how to determine the expenditure a person may deduct against their income from a mixed-use asset, see **QB 25/03**: **Income tax – How do the mixed-use asset rules apply if I provide short-stay accommodation?**

Quarantined expenditure

42. If a person's residential property is a mixed-use asset and the person makes a loss from the rental activities, they must determine whether the quarantined expenditure rules apply (s DG 16).

43. The expenditure quarantine rules apply to a mixed-use asset if:

- income derived from the use of the asset (other than exempt income) during the income year is less than 2% of the mixed-use asset's value; and
- the person incurs expenditure for the income year.

44. For more detailed guidance on when the quarantined expenditure rules apply, see QB 25/03.

45. If the quarantined expenditure rules apply, the person may only deduct their expenses up to the amount of rental income they received from the mixed-use asset. A person cannot offset the amount of the expenses over and above the amount of asset income against their income from other sources (for example, salary and wage income). Instead, that amount of expenses is quarantined and carried forward to a future income year. The discussion from [62] explains how a person can use quarantined expenditure in future income years.

Standard tax rules

46. If a person derives income from a residential property during the income year and the property is not within the scope of the mixed-use asset rules, they must apply the standard tax rules to calculate their taxable income.

47. Any income a person receives from renting a residential property is generally taxable income (s CC 1). A person must determine what deductions they can claim for expenditure incurred in deriving the rental income (s DA 1).

48. The starting point is that a person can fully deduct expenses that relate solely to their rental activity.[2] Conversely, any expenses that relate solely to their private use of the property are non-deductible.

49. To the extent an expense relates to both a person's income-earning and private use of the property, it will be only partly deductible.

2 However, interest may not be fully deductible until 1 April 2025. Further, if the dwelling is rented through an online marketplace, the person may need to claim their deduction on a GST-exclusive basis (as QB 25/04 explains).

50. For further information on how to apply the standard rules, see **QB 25/04**: **Income tax – How do the standard tax rules apply if I provide short-stay accommodation?** and **QB 23/08**: **Income tax – deductibility of expenditure – renting to flatmates**.

51. If the standard tax rules apply to the residential property, a person must also consider whether the residential property ring-fencing rules apply.

Residential property ring-fencing rules

52. The residential property ring-fencing rules may apply when a person owns a residential property and has expenditure or a loss that relates to the property for which they are allowed a deduction.

53. The residential property ring-fencing rules operate to prevent a person from offsetting deductions incurred for residential properties against other sources of income (for example, salary or wages). This means if the person's rental activity makes a loss (that is, the deductible expenses exceed the income), they cannot claim the excess deductions (that is, the extent to which they exceed the income) in that income year (s EL 4). Any excess deductions are not permanently forfeited but are suspended and may be offset against future income derived from residential property. The discussion from [67] explains how a person can use the unused excess deductions in future income years.

54. There are several exclusions from the residential property ring-fencing rules (see ss EL 9 to EL 13), including exclusions for a main home and for mixed-use assets.

Main home exclusion

55. The main home exclusion (s EL 9) applies if:
    - more than 50% of the land is used as the person's main home (the space threshold); and
    - the person uses the land as their main home for more than 50% of the income year (the time threshold).

56. A "main home" is the one dwelling that a person mainly uses as a residence (s YA 1). In determining what a person's main home is, if they have more than one home, the focus is on the nature of the place and the relationship between the person and that place – see **QB 24/01**: **If a person has two or more homes, which home is their main home for the purpose of the main home exclusion to the bright-line test?**

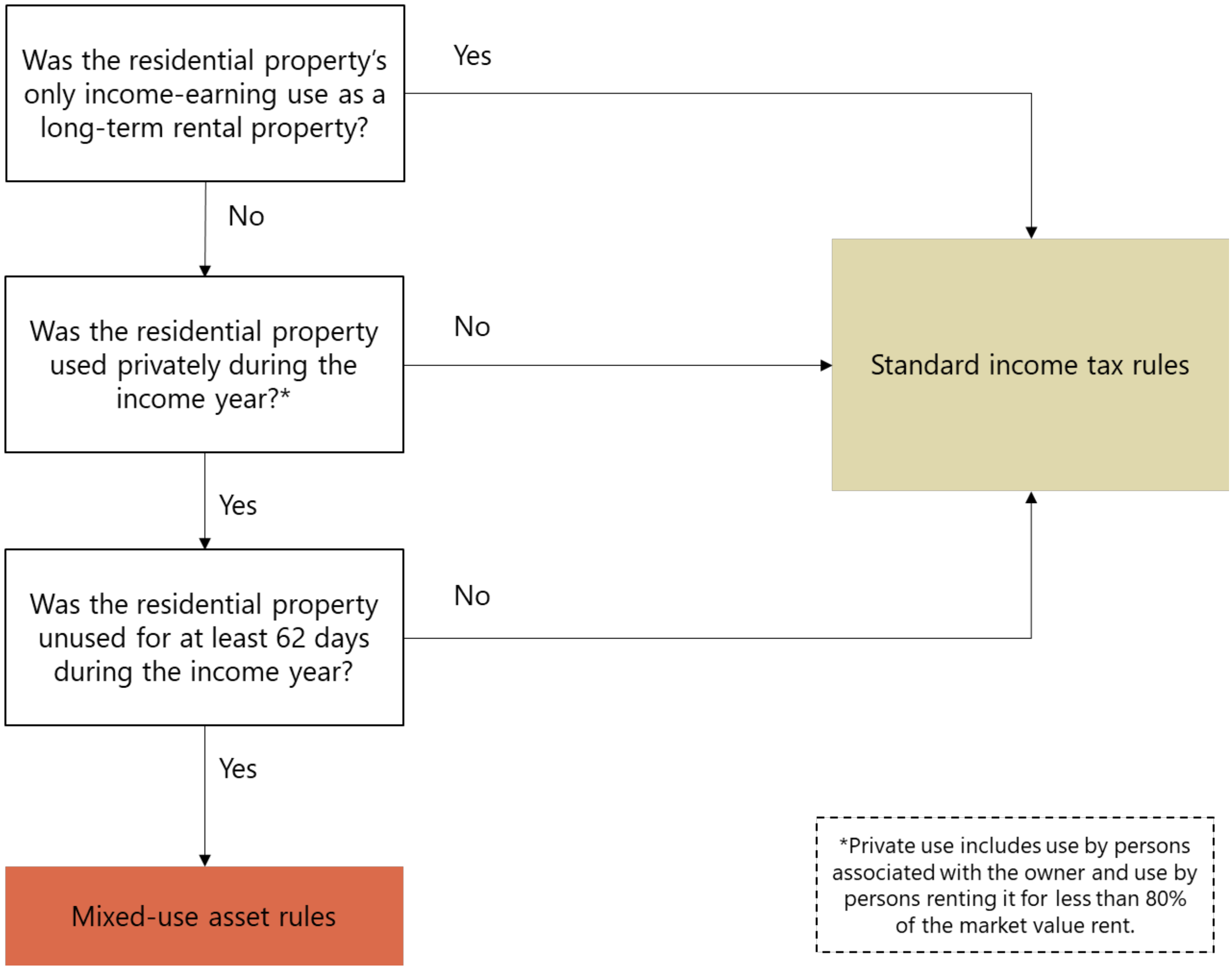
57. The main home exclusion can apply if a trust owns the residential property, provided:
    - a beneficiary of the trust occupies the property as their main home; and
    - either the principal settlor of the trust does not have a main home or, if they do, it is the property in question.

Mixed-use asset exclusion

58. The residential property ring-fencing rules do not apply to residential land for an income year when the land is an asset within the scope of the mixed-use asset rules (s EL 12).

59. **Figure | Hoahoa 1**, **Example | Tauira 1** and **Example | Tauira 2** provide guidance on how a person can work out which income tax deduction rules apply to their residential property.

Figure | Hoahoa 1 – Determining which income tax deduction rules apply to residential property you earn income from



Example | Tauira 1 – A property changing from being the owner's residence to a long-term residential rental

Anaru owns a three-bedroom property in Taupō. After he purchased the property in 2021, Anaru lived in the property with two flatmates. In the 2023–24 income year (the income year ending 31 March 2024), he receives a promotion from his employer and moves to Napier to take up the new role. Anaru moves out of the Taupō property on 15 January 2024. Anaru's flatmates continue to live in the property under a tenancy arrangement.

Anaru's deductions for the Taupō property are not ring-fenced in the 2023–24 income year as the main home exclusion applies. Anaru has used the entire Taupō property as his main home for more than 50% of the income year.

The mixed-use asset rules do not apply to the Taupō property for the 2023–24 income year as the property was not unused for 62 or more days during the income year; it was used for the whole income year.

Anaru must apply the standard tax rules to work out his tax obligations in relation to the property for the 2023–24 income year (see QB 23/08).

Example | Tauira 2 – A property changing from being a mixed-use asset to a long-term residential rental

Susie owns a three-bedroom property in Dunedin. For the first 4 months of the 2021–22 income year, Susie lives in the property and lets one of the bedrooms as short-stay accommodation. Susie lets the bedroom at a market rent, and it has approximately 60% occupancy during those 4 months.

In August 2021, Susie moves back to her parents' home and her Dunedin property is left vacant. In November 2021, Susie decides to rent her Dunedin property to long-term tenants.

During the 2021–22 income year, Susie has used the Dunedin property privately (as her residence) and has used it to derive income (rental income). The Dunedin property was also vacant for more than 62 days during the income year.

The Dunedin property will be in the mixed-use asset rules for the income year unless one of the asset exclusions applies.

An asset is excluded from the mixed-use asset rules if it is a residential property and the **only** income-earning use is as a long-term rental property. Susie has earned income from the Dunedin property from short-stay accommodation and long-term rental during the 2021–22 income year. Therefore, the long-term rental exclusion does not apply, as long-term rental income was not the sole source of Susie's income from the Dunedin property for the income year.

As the Dunedin property is a mixed-use asset, the residential property ring-fencing rules do not apply due to the mixed-use asset exclusion from the ring-fencing rules. Instead, the mixed-use asset rules will apply to the Dunedin property.

For completeness, the main home exclusion from the residential property ring fencing rules will not apply as Susie has not used the Dunedin property as her main home for more than 50% of the 2021-22 income year. The Dunedin property was Susie's main home for only 4 months of the 2021-22 income year.

Susie must apply the mixed-use asset rules to calculate her deductible expenditure for the Dunedin property for the 2021–22 income year (see QB 25/03).

In the 2022–23 income year, Susie continues to live at her parents' home and rent the Dunedin property as a long-term rental. The standard tax rules apply to the Dunedin property in the 2022–23 income year, because the long-term rental exclusion from the mixed-use asset rules applies.

In the 2022–23 income year, the Dunedin property is subject to the residential property ring-fencing rules as neither the main home exclusion nor the mixed-use asset exclusion from the ring-fencing rules applies.

Part two – Prior year quarantined expenditure or unused excess deductions

60. In some cases where a residential property has made a loss, a person may have either:
    - quarantined expenditure under the mixed-use asset rules (see from [62]); or
    - unused excess deductions under the residential property ring-fencing rules (see from [67].

61. The person must determine whether they can offset the quarantined expenditure or unused excess deductions suspended from prior income years against their current year income.

Offsetting prior year mixed-use asset quarantined expenditure against current year income

62. Mixed-use asset quarantined expenditure carried forward from a prior income year may be offset against "asset income" in the current income year (s DG 17).

Asset income

63. "Asset income" is the total amount of taxable income derived in the current income year from the use of the asset. The mixed-use asset rules define "asset". Residential property will be an "asset" for the mixed-use asset rules if it meets specific criteria, including criteria relating to the use of the asset – see [31].

64. If the residential property has previously been in the mixed-use asset rules but does not meet the criteria of an asset in the current income year because the use of the asset has changed, the owner will not derive any asset income. Therefore, the owner will not be able to use quarantined expenditure carried forward from a prior income year in the current income year. This is illustrated in Example | Tauira 3.

65. The quarantined expenditure continues to be carried forward to future income years. The person may offset it against income in a future income year when the residential property is a mixed-use asset, and they derive asset income from the residential property.
66. Generally, quarantined expenditure from a mixed-use asset cannot be used against any income derived from a different mixed-use asset. If the mixed-use asset with quarantined expenditure is sold, any prior-year quarantined expenditure that cannot be deducted in the income year of sale is forfeited. However, quarantined expenditure can be offset against the asset income derived from a different mixed-use asset if (s DG 17(6)):
    - the first asset is damaged or lost; and
    - the second asset is acquired to replace the first asset; and
    - the two assets are identical or substantially the same.

Example | Tauira 3 – Claiming deductions for prior-year quarantined expenditure

Following on from Example | Tauira 2, in the 2021–22 income year Susie made a loss from her Dunedin property and had quarantined expenditure under the mixed-use asset rules. Susie did not opt out of the mixed-use asset rules in the 2021–22 income year.

In the 2022–23 income year, Susie is unable to claim a deduction for the quarantined expenditure from the 2021–22 income year and any other prior income year, as the Dunedin property is no longer a mixed-use asset and Susie does not derive any "asset income" in the income year.

The mixed-use asset quarantined expenditure for the 2021–22 income year and any other prior income year will be carried forward. It will be available for Susie to deduct in a future income year if the Dunedin property becomes a mixed-use asset again.

Offsetting unused excess deductions against current year income

67. If residential property is subject to the residential property ring-fencing rules in an income year, a person will have unused excess deductions if their deductible expenditure exceeds their "residential income".
68. A person cannot offset the unused excess deductions against their income from other sources (for example, salary and wage income).
69. Unused excess deductions are carried forward to future income years and can be offset against future residential income the person derives from their residential property or portfolio.
70. What happens to any unused excess deductions if a residential property is sold depends on:
    - whether the residential property ring-fencing rules were applied to a portfolio of properties or on a property-by-property basis; and
    - whether the residential property or portfolio was fully taxed on sale – see **IS 23/10: Deductibility of holding costs for land**.

Residential income

71. "Residential income" is defined for the purposes of the residential property ring-fencing rules (s EL 3). In general terms, "residential income" includes rental income and any depreciation recovery income a person derives in relation to their "residential portfolio" or individual property that is subject to s EL 4.
72. The default position is that the residential property ring-fencing rules apply on a portfolio basis. However, a person can elect to apply the rules on a property-by-property basis instead.

Residential portfolio

73. Unless a person has elected to apply the residential property ring-fencing rules on a property-by-property basis, their residential portfolio will consist of all residential rental properties they have included in their residential portfolio. The portfolio basis allows a person to calculate their total profit or loss across all residential properties in their portfolio that are subject to deductions being allocated under s EL 4 in that income year. The income from all properties in the portfolio subject to s EL 4 is offset, up to the amount of income from the portfolio, by deductions from all properties in the portfolio subject to s EL 4.

74. If a person has included a residential property in their portfolio at any time, it will remain part of their residential portfolio even if in a subsequent income year an exclusion (for example, the main home exclusion or the mixed-use asset exclusion) applies. The exclusions do not stop the residential property from being part of the person's residential portfolio. This is relevant in the income year the person sells the last of the properties in their residential portfolio. However, if an exclusion applies for a particular income year, s EL 4 does not apply to limit deductions for that income year for that property.
75. Despite a residential property remaining part of a person's residential portfolio if it has been included in the portfolio at any time, if the residential property is excluded from the s EL 4 limitation in a particular income year, neither the income nor the deductions for the property for that income year are taken into account for the purposes of applying s EL 4 to the properties in the person's portfolio that are not excluded. This has the effect that the person cannot offset:
    - deductions for expenditure incurred relating to other properties in their residential portfolio against income from the excluded property; or
    - any carried forward unused excess deductions relating to the residential portfolio against income from the excluded property.
76. A person will be able to carry forward the unused excess deductions to future income years. This is illustrated in **Example | Tauira 4**.

Property-by-property basis

77. The same principles for offsetting excess deductions apply if a person has elected to apply the residential property ring-fencing rules on a property-by-property basis. This is illustrated in **Example | Tauira 5**.
78. If a person has chosen to apply the rules on a property-by-property basis, the residential income they derive, along with the expenditure or loss, must relate solely to that individual property (property A). Any excess amount in relation to property A is suspended as a deduction and carried forward to a later income year in which the person derives residential income from property A (s EL 6).

Example | Tauira 4 – Offsetting unused excess deductions – portfolio basis

Rohan owns three residential properties. All three residential properties have been rented to tenants on a long-term basis. The residential properties have been subject to the residential property ring-fencing rules.

Rohan applies the residential property ring-fencing rules on a portfolio basis.

2021–22 income year

In the 2021–22 income year, Rohan's rental activity is as follows:

Residential portfolio	Residential income	Deductible expenditure	Expenditure deductible in the 2021–22 income year	Excess deductions carried forward to future income year
Property A	$16,500	$16,500		
Property B	$20,000	$19,000		
Property C	$5,000	$13,000		
Total	**$41,500**	**$48,500**	**$41,500**	**$7,000**

In the 2021–22 income year, Rohan can claim $41,500 of the expenses incurred for the properties in his portfolio. He has $7,000 of unused excess deductions to carry forward to the 2022–23 income year.

Rohan's tax summary for the 2021–22 income year is:

Taxable income	$0
Excess deductions to carry forward	$7,000

2022–23 income year

During the 2022–23 income year, the long-term tenants in Property C move out. Property C is unoccupied for a 3-month period and Rohan then lives in the property for a short time while his home is being renovated. Rohan then decides to let Property C as short-stay accommodation for the remainder of the income year. As a result of the change of use, Property C satisfies the mixed-use asset criteria in the 2022–23 income year.

For the 2022–23 income year, Rohan must apply the mixed-use asset rules, instead of the standard tax rules and the residential property ring-fencing rules, to determine his tax obligations relating to Property C. After calculating the deductions, he can claim for Property C under the mixed-use asset rules, Rohan calculates that his net income derived from Property C is $3,500.

In the 2022–23 income year, Rohan's rental activity from his residential portfolio is as follows:

Residential portfolio	Residential income	Deductible expenditure	Expenditure deductible in the 2022–23 income year	Excess deductions carried forward to future income year
Property A	$16,500	$15,500		
Property B	$20,000	$20,000		
Excess amounts carried forward from prior income year		$7,000		
Total	**$36,500**	**$42,500**	**$36,500**	**$6,000**

The excess amounts carried forward from the prior income year are added to the deductible expenses for the 2022–23 income year. The amount Rohan can claim in the 2022–23 income year is the greater of the total deductible expenses and the residential income from the portfolio for the income year. In this case, that means Rohan can claim $36,500 of the expenses and has $6,000 of unused excess deductions to carry forward to the 2023–24 income year. The effect of this is that Rohan has been able to offset $1,000 of the prior-year unused excess deductions against his residential income in the 2022–23 income year.

However, as Property C is a mixed-use asset and excluded from the s EL 4 limitation in the 2022–23 income year, Rohan is unable to offset any unused excess deductions against the income relating to Property C. Rohan is taxed on his net income from Property C of $3,500.

Rohan's tax summary for the 2022–23 income year is:

Taxable income	$3,500
Excess deductions to carry forward	$6,000

2023–24 income year

Rohan secures a long-term tenant for Property C in April 2023. Property C is not a mixed-use asset in the 2023–24 income year and is once again a residential property subject to the s EL 4 limitation in the residential property ring-fencing rules.

In the 2023–24 income year, Rohan's rental activity from his residential portfolio is as follows:

Residential portfolio	Residential income	Deductible expenditure	Expenditure deductible in the 2023–24 income year	Excess deductions carried forward to future income year
Property A	$16,500	$16,000		
Property B	$20,000	$22,000		
Property C	$15,000	$13,000		
Excess amounts carried forward from prior income year		$6,000		
Total	**$51,500**	**$57,000**	**$51,500**	**$5,500**

The excess amounts carried forward from the prior income year are added to the deductible expenses for the 2023–24 income year. The amount Rohan can claim in the 2023–24 income year is the greater of the total deductible expenses and the residential income from the portfolio for the income year. In this case, that means Rohan can claim $51,500 of the expenses and has $5,500 of unused excess deductions to carry forward to the 2024–25 income year. The effect of this is that Rohan has been able to offset $500 of the prior-year unused excess deductions against his residential income in the 2023–24 income year.

Rohan's tax summary for the 2023–24 income year is:

Taxable income $0

Excess deductions to carry forward $5,500

Example | Tauira 5 – Offsetting unused excess deductions – property-by-property basis

The same facts apply as in **Example | Tauira 4**, except that Rohan elects to apply the residential property ring-fencing rules to Property C on a property-by-property basis.

2021–22 income year

In the 2021–22 income year, Rohan's rental activity is as follows:

Residential portfolio	Residential income	Deductible expenditure	Expenditure deductible in the 2021–22 income year	Excess deductions carried forward to future income year
Property A	$16,500	$16,500		
Property B	$20,000	$19,000		
Total	**$36,500**	**$35,500**	**$35,500**	**$0**
Property-by-property basis				
Property C	$5,000	$13,000	$5,000	$8,000

Rohan has $8,000 of unused excess deductions to carry forward to the 2022–23 income year relating to Property C.

Rohan is able to claim the total $35,500 of expenses for his residential portfolio because the income from the portfolio exceeds that. Rohan therefore has net $1,000 of residential income from his residential portfolio.

Rohan's tax summary for the 2021–22 income year is:

Taxable income	$1,000
Excess deductions to carry forward	$8,000

2022–23 income year

In the 2022–23 income year, Rohan's rental activity from his residential portfolio is as follows:

Residential portfolio	Residential income	Deductible expenditure	Expenditure deductible in the 2022–23 income year	Excess deductions carried forward to future income year
Property A	$16,500	$15,500		
Property B	$20,000	$20,000		
Total	**$36,500**	**$35,500**	**$35,500**	**$0**

Rohan is able to claim the total $35,500 of expenses for his residential portfolio, as the income from the portfolio exceeds that. He therefore has net $1,000 of residential income from his residential portfolio.

Rohan's calculations of the deductions he can claim for Property C under the mixed-use asset rules show the net income he derived from Property C is $3,500. He is unable to offset any of the unused excess deductions relating to Property C that have been carried forward under the ring-fencing rules against the asset income derived in relation to Property C. Rohan is taxed on his net income from Property C of $3,500.

Rohan will have $8,000 of unused excess deductions to carry forward to the 2023–24 income year from Property C.

Rohan's tax summary for the 2022–23 income year is:

Taxable income	$4,500
Excess deductions to carry forward	$8,000

2023–24 income year

In the 2023–24 income year, Rohan's rental activity from his residential portfolio is as follows:

Residential portfolio	Residential income	Deductible expenditure	Expenditure deductible in the 2023–24 income year	Excess deductions carried forward to future income year
Property A	$16,500	$16,000		
Property B	$20,000	$22,000		
Total	**$36,500**	**$38,000**	**$36,500**	**$1,500**
Property-by-property basis				
Property C	$15,000	$13,000		
Excess amounts carried forward from prior income year		$8,000		
Total	**$15,000**	**$21,000**	**$15,000**	**$6,000**

The amount Rohan can claim in the 2023–24 income year in relation to his residential portfolio is the greater of the total deductible expenses and the residential income from the portfolio for the income year. In this case, that means Rohan can claim $36,500 of the expenses and has $1,500 of unused excess deductions relating to his residential portfolio to carry forward to the 2024–25 income year.

In relation to Property C, Rohan can claim $15,000 of the expenses and has $6,000 of unused excess deductions to carry forward to the 2024–25 income year. The effect of this is that Rohan has been able to offset $2,000 of the prior-year unused excess deductions against his residential income from Property C in the 2023–24 income year. Rohan has in total excess residential rental deductions of $7,500 available to carry forward to the 2024–25 income year.

Rohan's tax summary for the 2023–24 income year is:

Taxable income	$0
Excess deductions to carry forward	$7,500

Part three – Calculating depreciation deductions

79. A person may claim a depreciation deduction for an item of depreciable property (for example, stove, carpets, fridge) that they use for income-earning purposes. Since the 2011–12 income year it is no longer possible to claim any depreciation on the residential property itself (including any fixtures or improvements).[3] A person cannot claim a depreciation deduction for chattels they use solely for private purposes.

80. The application of the rules can become complicated when a person has calculated depreciation deductions under the mixed-use asset rules in one income year and under the standard tax rules in the next income year, or the other way around.

81. If the standard tax rules apply, a person must consider whether the residential property ring-fencing rules limit a deduction for any depreciation loss. If the mixed-use asset rules apply, the amount of the depreciation deduction is limited by the apportionment calculation and may also be limited under the mixed-use asset quarantined expenditure rules.

82. The first step is to calculate the depreciation loss for the income year for each item of depreciable property. The next step is to work out what proportion of those losses a person may claim as a deduction in the income year.

83. If a person claims a depreciation deduction, they must keep a schedule of all the items of depreciable property they are depreciating. This schedule should show the depreciation the person has claimed in previous income years and the adjusted tax value (ATV) of each item of depreciable property.

Calculating depreciation loss

84. Before a person can apply any apportionment method, they must work out the depreciation loss for the income year for each item of depreciable property.

85. For low-value items (up to $1,000), the depreciation loss is the depreciable property's cost. For other items of depreciable property, a person must work out the depreciation loss for the income year using either the diminishing value (DV) method or the straight-line (SL) method. For information about the methods and the depreciation rates, see Inland Revenue's website: **Depreciation rate finder and calculator**.

86. The starting point to calculate the depreciation loss is to determine the ATV. An item's ATV is its "base value" less "total deductions".

87. Generally, the "base value" is the cost a person incurred in purchasing the item of depreciable property.

88. The "total deductions" amount includes all deductions for amounts of depreciation loss the person has been allowed or would have been allowed if the person had used the item wholly in deriving assessable income or carrying on a business for the purpose of deriving assessable income. That is, the "total deductions" amount is the amount before any apportionment under either the mixed-use asset rules or the standard tax rules.

89. **Example | Tauira 6** illustrates how to calculate depreciation loss on a chattel used in a residential property.

Example | Tauira 6 – Calculating depreciation loss

Marama owns a two-bedroom property in Kaikōura.

Marama purchases a new leather lounge suite for $7,500 on 1 April 2020 for her Kaikōura property. The depreciation rate for loose furniture is 20% DV.

Marama calculates her depreciation loss for the 2020–21 income year as follows:

Opening ATV	Depreciation loss	Closing ATV
7,500	1,500	6,000

Example | Tauira 7 shows how Marama calculates her depreciation deduction for the 2020–21 income year.

3 For the 2011–12 income year and subsequent income years, depreciation on residential buildings is 0% where buildings have an estimated life of more than 50 years.

Determining the depreciation deduction under the standard tax rules

90. Under the standard tax rules, a person can claim depreciation on items of depreciable property that they use or that are available for them to use in deriving taxable income.

91. If the item of depreciable property is wholly used to derive taxable income, the person can claim the full depreciation loss as a deduction. The next step is to determine whether the deduction is suspended under the residential property ring-fencing rules.

92. If the item of depreciable property is partly used to derive taxable income, the person must apportion between private and income earning use. The specific apportionment formula for depreciation of items partly used to earn income is (s EE 50):

depreciation loss × qualifying use days ÷ all days

93. "Qualifying use days" is the number of days the residential property is rented out or is available to be rented out. "All days" is the number of days in an income year the residential property is used or available for use for any purpose.

94. Where a person uses an item of depreciable property partly for private use and partly to earn income, s EE 50(2) states that the depreciation deduction "must not be more" than the amount calculated using the formula.

95. However, the depreciation deduction may be less than the amount calculated under the formula. This would be the case where the person uses the depreciable property for private purposes and to derive taxable income on the same day. In this situation, apportionment under the general permission for deductibility is appropriate (s DA 1). For example, if the item of depreciable property is used for both private and income earning purposes at the same time (for example, it is in a common use area) the Commissioner would generally accept the amount of the depreciation loss being apportioned 50:50 between the private use and the income-earning use (so 50% deductible and 50% non-deductible). However, where the actual use of the asset can be clearly demonstrated, an alternative basis may be adopted if it reflects a reasonable basis of apportionment.

Depreciation deductions may be suspended under the residential property ring-fencing rules

96. If a person uses the standard tax rules to calculate their depreciation deduction, they must also consider whether the residential property ring-fencing rules apply.

97. If the residential property ring-fencing rules apply to the residential property for the income year, the person may need to suspend a portion of the depreciation deduction (together with all other deductions for the property) and carry it forward to a future income year as an unused excess deduction.

98. Suspending a depreciation deduction in an income year does not change how the person calculates their depreciation loss in the next income year. A person calculates the ATV based on the total deductions they could have claimed before any suspension (see [88]).

99. A person must maintain records of any suspended depreciation deductions and track whether the amount is claimed as a deduction in a future income year. If the suspended depreciation deduction is claimed in a future income year this will impact how depreciation recovery income (see from [107]) or depreciation loss on sale (see from [118]) is calculated.

Determining the depreciation deduction under the mixed-use asset rules

100. If the residential property is a mixed-use asset, the mixed-use asset rules override the partial use rules in subpart EE.

101. Under the mixed-use asset rules, a person is allowed a deduction for an amount of depreciation loss to the extent of the amount calculated using the formula in s DG 9(2). The apportionment formula is set out in [39]. The effect of the formula is that the proportion of the depreciation loss that is deductible reflects the income-earning use of the mixed-use asset relative to the private use.

102. If the quarantined expenditure rules apply (see [42]) a person must quarantine a portion of the depreciation deduction and carry it forward to a future income year.

103. Any limitation of the depreciation deduction due to the mixed-use asset apportionment formula or the quarantined expenditure rules, does not change how a person calculates their depreciation loss in the next income year.

104. **Example | Tauira 7** illustrates how depreciation deductions are calculated when the income tax deduction rules that apply to the residential property changes.

Example | Tauira 7 – Calculating depreciation deductions on chattels where the land regime that applies to a residential property changes

The same facts apply as in **Example | Tauira 6**.

During the 2020–21 income year, Marama stayed in her property from 20 December 2020 to 15 February 2021 (57 nights) and made the property available for short-stay accommodation for the remainder of the income year. In the 2020–21 income year, the property was booked for 170 nights and unused for the other 138 nights that it was available for short-stay accommodation. Marama's Kaikōura property is a mixed-use asset for the 2020–21 income year – see **QB 25/02**.

Because Marama's Kaikōura property is a mixed-use asset, Marama must determine the portion of the depreciation loss that is deductible under the mixed-use asset rules.

For the purposes of this example, Marama calculates her expenditure on the basis that the depreciation loss is her sole item of expenditure or loss.

Marama calculates her mixed-use asset expenditure using the following formula:

$$\text{expenditure} \times \text{income-earning days} \div (\text{income-earning days} + \text{counted days})$$

Expenditure = $1,500

Income-earning days = 170

Counted days = 57

Marama's mixed-use asset expenditure is $1,123.35.

Marama's deprecation deduction is $1,123.35. The amount of the depreciation deduction due to the mixed-use asset rules will not affect the calculation of the ATV of the leather lounge suite in the next income year. The ATV is $6,000 ($7,500 less $1,500) for the 2021–22 income year.

Towards the end of the 2020–21 income year, Marama is getting fewer short-stay bookings, so she decides to let the Kaikōura property to a tenant on a long-term basis. Marama's tenant occupies the Kaikōura property from 1 April 2021 to 31 March 2023.

As the Kaikōura property is not used privately during the 2021–22 income year or the 2022–23 income year, it will not be a mixed-use asset in those income years. The standard tax rules will apply to the Kaikōura property.

Marama calculates her depreciation loss in the 2021–22 and 2022–23 income years:

	Opening ATV	Depreciation loss	Closing ATV
2022	$6,000	$1,200	$4,800
2023	$4,800	$960	$3,840

Marama's rental activity makes a loss in both the 2021–22 and 2022–23 income years. Marama calculates that because of the application of the residential rental ring-fencing rules, she can claim deductions for 66.66% of her total expenditure for the property in the 2021–22 income year and 72.39% of her total expenditure for the property in the 2022–23 income year (that is, Marama's income from the residential property is 66.66% and 72.39% of the expenditure incurred in the 2021–22 and 2022–23 income years respectively).

On this basis, the depreciation deduction Marama can claim is limited to $800 in the 2021–22 income year and $695 in the 2022–23 income year.

The remainder of the depreciation deduction ($400 in the 2021–22 income year and $265 in the 2022–23 income year) is suspended and carried forward to future income years.

Part four - Sale of depreciable property

105. A person must calculate their depreciation recovery income or depreciation loss on sale if they:
   - sell an item of depreciable property; or
   - the item of depreciable property is not used to derive income (for example, they have sold the residential property the depreciable property was used in conjunction with).

106. The method to calculate depreciation recovery income or depreciation loss on sale is the same whether the mixed-use asset rules or standard tax deduction rules apply in the income year of disposal.[4]

Calculating depreciation recovery income

107. Depreciation recovery income arises when the depreciable property is sold for more than its ATV.

108. Generally, the depreciation recovery income is the lesser of:
   - the amount by which the consideration is more than the item's ATV on the date of disposal; and
   - the total of the amounts of depreciation loss for which a person has been allowed deductions for the item of depreciable property.

109. However, when a person partly used the item of depreciable property to produce income (for example, an item of depreciable property in a mixed-use asset), they must use a specific formula to calculate the depreciation recovery income (s EE 49).

Sale of depreciable property partly used to produce income

110. Section EE 49 applies if:
   - at any time during the period a person owns an item of depreciable property, they determine the depreciation deduction under s EE 50 (see [92]); or
   - the item of depreciable property is used in a mixed-use asset.

111. The formula in s EE 49 is:

$$\text{(all deductions} \div \text{(base value} - \text{adjusted tax value))}$$
$$\times \text{ amount of depreciation recovery income}$$

   where:
   - "all deductions" means all amounts of depreciation loss for which the person has been allowed a depreciation deduction;
   - "base value" generally means the cost of the item of depreciable property;
   - "adjusted tax value" is the item's base value less "total deductions"; and
   - "amount of depreciation recovery income" is the amount by which the sale proceeds is more than the item's ATV on the date on which the item is sold.

112. The depreciation recovery income formula takes into account deductions that have been allowed. If a person did not deduct all or part of a depreciation loss due to the mixed-use asset apportionment formula, the mixed-use asset quarantined expenditure rules, or the residential property ring-fencing rules, the denied amount would not be clawed back as depreciation recovery income.

113. After calculating depreciation recovery income, a person can determine the extent to which they can use unused excess deductions under the residential property ring-fencing rules, to offset the depreciation recovery income.

Offsetting unused excess deductions against depreciation recovery income

114. A person can offset unused excess deductions against depreciation recovery income if the residential property ring-fencing rules apportionment mechanism (s EL 4) applies to the residential property in the income year in which they sell the item of depreciable property. This is illustrated in **Example | Tauira 8**.

4 Section DG 8(2)(b) and (c) provide that for a mixed-use asset, depreciation recovery income is dealt with in s EE 49 and a depreciation loss on disposal is dealt with in ss EE 44 to EE 48 and s EE 50(6) and (7).

115. However, if the s EL 4 allocation mechanism does not apply to the residential property in the income year in which the person sells the item of depreciable property, they cannot use any previously unused excess deductions. While the depreciation recovery income will be residential income (s EL 3), if s EL 4 does not apply to the residential property due to an exclusion (for example, because it is a mixed-use asset for that income year (s EL 12)), the person cannot use any previously unused excess deductions against the depreciation recovery income. This is illustrated in **Example | Tauira 9**.

Unable to use prior-year mixed-use asset quarantined expenditure against depreciation recovery income

116. Mixed-use asset quarantined expenditure carried forward from a prior income year may be offset against “asset income” in the current income year (s DG 17). “Asset income” is the total amount of taxable income derived in the current income year from “the use of the asset” (s DG 17(3)(a)).

117. While depreciation recovery income generally consists of the reversal of depreciation deductions, it arises on the sale of the depreciable property rather than from the use of the asset. Because depreciation recovery income is not “asset income”, a person cannot offset prior-year mixed-use asset quarantined expenditure against depreciation recovery income.

Example | Tauira 8 – How to calculate depreciation recovery income from the sale of an item of depreciable property in a residential rental property

The same facts apply as in **Example | Tauira 6** and **Example | Tauira 7**. Marama’s depreciation treatment of the leather lounge suite is as follows:

Income year	Opening ATV	Depreciation loss	Closing ATV	Deductions
2020–21	$7,500	$1,500	$6,000	$1,123.35
2021–22	$6,000	$1,200	$4,800	$800
2022–23	$4,800	$960	$3,840	$695

Marama continues to rent out her Kaikōura property to a long-term tenant in the 2023–24 income year. On this basis, Marama uses the standard tax rules to calculate her income and expenditure from the Kaikōura property.

On 1 April 2023 Marama sells the lounge suite for $5,000.

Because the sale proceeds are more than the lounge suite’s closing ATV, Marama must determine her depreciation recovery income using the following formula:

$$(\text{all deductions} \div (\text{base value} - \text{adjusted tax value})) \times \text{amount of depreciation recovery income}$$

All deductions = $2,618.35 ($1,123.35 + 800 + 695)

Base value = $7,500

Adjusted tax value = $3,840

Amount of depreciation recovery income = $1,160 ($5,000 less $3,840)

Total depreciation recovery income = $829.86

Marama must return the depreciation recovery income in her 2023–24 income tax return.

The standard tax rules and residential property ring-fencing rules apply to the Kaikōura property in the 2023–24 income year. On this basis, Marama will be able to offset her unused excess deduction carried forward from earlier income years.

Marama calculates her net income as follows:[5]

Depreciation recovery income	$829.86
Excess amounts carried forward from prior year – 2021–22	($400)
Excess amounts carried forward from prior year – 2022–23	($265)
Net income	**$164.86**

5 For the purpose of this example, we have ignored any rental income or other deductions for the income year.

INTERPRETATION STATEMENTS

Example | Tauira 9 – How to calculate depreciation recovery income from the sale of an item of depreciable property used in a mixed-use asset

Hudson owns a three-bedroom property in Hamilton. He purchased it as a rental investment and let it to tenants from 1 April 2021 to 31 March 2023.

The standard tax rules applied to the Hamilton property in the 2021–22 and 2022–23 income years. The residential property ring-fencing rules apply to limit Hudson's deductions in the 2021–22 and 2022–23 income years.

Hudson let the three-bedroom property partially furnished and then purchased a new dining suite for $2,500 on 1 April 2021. The depreciation rate for loose furniture is 13.5% SL.

During the 2023–24 income year, Hudson's tenants move out. Hudson is unable to secure new tenants, and the property is unoccupied for 3 months until he decides to move into the property himself.

The Hamilton property is a mixed-use asset for the 2023–24 income year.

Hudson's depreciation treatment of the dining suite is as follows:

Income year	Opening ATV	Depreciation loss	Closing ATV	Deduction
2021–22	$2,500.00	$337.50	$2,162.50	$280.00
2022–23	$2,162.50	$337.50	$1,825.00	$275.00
2023–24	$1,825.00	$337.50	$1,487.50	$130.00

In the 2023–24 income year, $207.50 of the depreciation loss was disallowed as a deduction under the mixed-use asset rules. The amount of disallowed depreciation loss includes $83 of quarantined expenditure (that is, expenditure that is not deductible in the income year but instead carried forward to a future income year for use against income derived from the Hamilton property in the future).

On 1 April 2024, Hudson decides to sell the dining suite for $2,000.

Because the sale proceeds Hudson receives are more than the dining suite's closing ATV, he must return depreciation recovery income using the following formula:

$$(\text{all deductions} \div (\text{base value} - \text{adjusted tax value})) \times \text{amount of depreciation recovery income}$$

All deductions = $685 ($280 + $275 + $130)

Base value = $2,500

Adjusted tax value = $1,487.50

Amount of depreciation recovery income = $1,012.50 ($2,500 less $1,487.50)

Total depreciation recovery income = $685

Hudson must return the depreciation recovery income of $685 in his 2023–24 income tax return.

The standard tax rules do not apply to the Hamilton property in the 2023–24 income year. For this reason, Hudson cannot offset his unused excess deductions carried forward from the 2021–22 income year ($57.50) and 2022–23 income year ($62.50). Further, Hudson cannot offset the prior-year quarantined expenditure amount ($83) against the depreciation recovery income.

Calculating depreciation loss on sale

118. If a person sells an item of depreciable property for less than the item's ATV, they will incur a depreciation loss on sale (s EE 48(2)).

119. Generally, the amount of the depreciation loss on sale is the amount by which the consideration is less than the item's ATV on that date. However, when a person partly uses the item of depreciable property to produce income (for example, an item of depreciable property in a mixed-use asset), they must use a specific formula to calculate the depreciation recovery income (s EE 50(6)).

Sale of depreciable property partly used to produce income

120. The formula in s EE 50(6) applies if a person sells an item of depreciable property at a loss and, during the period they owned that item, they used it partly to produce income and calculated the amount of depreciation deduction under s EE 50(2).

121. The formula in s EE 50(6) is:

disposal depreciation loss × all deductions
÷ (base value – adjusted tax value at date of disposal)

where:

- "disposal depreciation loss" means the sale consideration less the ATV;
- "all deductions" means all amounts of depreciation loss for which the person has been allowed a depreciation deduction;
- "base value" generally means the cost of the item of depreciable property; and
- "adjusted tax value at date of disposal" is an item's base value less "total deductions" at the date of sale.

122. The effect of the formula is that the loss on sale is apportioned in the same proportion as the depreciation deductions were apportioned.

123. **Example | Tauira 10** illustrates how to calculate depreciation loss on the sale of an item of depreciable property.

Example | Tauira 10 – Calculating depreciation loss from the sale of an item of depreciable property used in a mixed-use asset

Keely owns a two-bedroom holiday home in Arrowtown. It is a mixed-use asset, and she calculates her income and expenditure from the holiday home under the mixed-use asset rules.

Keely purchases a $1,800 fridge for her holiday home on 1 April 2021. The depreciation rate for fridges is 17.5% SL.

Keely's depreciation loss is as follows:

Income year	Opening ATV	Depreciation loss	Closing ATV	Deductions
2021–22	$1,800	$315	$1,485	$236
2022–23	$1,484	$315	$1,170	$283
2023–24	$1,170	$315	$855	$267

The mixed-use asset apportionment formula has limited Keely's depreciation deductions in the 2021–22 to 2023–24 income years.

Keely sells the fridge for $500 on 1 April 2024. As the amount Keely receives is less than the fridge's ATV, she has incurred a depreciation loss on sale.

Keely calculates her depreciation loss on sale using the following formula:

disposal depreciation loss × all deductions
÷ (base value – adjusted tax value at date)

Disposal depreciation loss = $355 ($855 less $500)

All deductions = $786 ($236 + $283 + $267)

Base value = $1,800

Adjusted tax value at date = $855

Total depreciation loss on disposal = $295.27

Keely will be able to claim a deduction in the 2024–25 income year for the depreciation loss on disposal of $295.27.

INTERPRETATION STATEMENTS

References | Tohutoro

Legislative references | Tohutoro whakatureture

Income Tax Act 2007 – ss CC 1, DA 1, DG 3, DG 8, DG 9, DG 16, DG 17, DG 21, EE 38, EE 44 to EE 48, EE 49, EE 50, EL 3, EL 4, EL 6, EL 9, EL 12, and the definition of "main home" in s YA 1

Other references | Tohutoro anō

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QB 25/02: Income tax – Which rules apply if I have a dwelling I sometimes rent out as short-stay accommodation and also sometimes use privately?
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taxtechnical.ird.govt.nz/tib/volume-36---2024/tib-vol36-no1
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IS 25/09: Tax treatment of losses on amalgamation

Issued | Tukuna: 4 April 2025

This interpretation statement provides guidance on when losses incurred before an amalgamation by an amalgamating company, an amalgamated company or another company that is within the group but not a party to the amalgamation, can be used after the amalgamation.

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

Key terms | Kīanga tau tāpua

Amalgamation	An amalgamation that occurs under Part 13 or 15 of the Companies Act 1993 (or under a foreign law that has the same or similar effect) that causes two or more companies to amalgamate and continue as one company. Includes certain transfers between building societies under s 33 of the Building Societies Act 1965.
Amalgamating company	A company that amalgamates with one or more other companies under an amalgamation. Generally, it includes both any company that ceases to exist after the amalgamation and the continuing company. However, in this statement, unless otherwise specified, **amalgamating company** means only the company that ceases to exist after an amalgamation.
Amalgamated company	The company that continues or survives after an amalgamation or a new company (ie, the continuing company).
Concessionary amalgamation	An amalgamation that is a "resident's restricted amalgamation" (as defined in s FO 3 the Act) and receives concessionary tax treatment under subpart FO.
Non-concessionary amalgamation	An amalgamation either that does not meet the criteria for a concessionary amalgamation or that the companies elect not to treat as a concessionary amalgamation.
Amalgamation tax year	The tax year corresponding to the income year in which the amalgamation takes place.
Pre-amalgamation part year	In the income year in which the amalgamation takes place, the part of the income year ending with the date of amalgamation.
Post-amalgamation part year	In the income year in which the amalgamation takes place, the part of the income year that begins on the day following the date of amalgamation.

Summary | Whakarāpopoto

1. The general loss rules allow a company with a tax loss component to:
   - carry forward a tax loss to a subsequent tax year – where the company will use that loss to reduce its net income (if any) or add it to the tax loss for the subsequent tax year; or
   - share a tax loss with a company in a group of companies that has net income.
2. Special provisions (in subpart IE) apply to tax losses when companies amalgamate. This interpretation statement explains how the provisions in subpart IE apply to the tax losses of an amalgamated company, amalgamating company or a non-amalgamating group company, that arise **before** amalgamation.

3. The general tax loss rules apply to the tax losses of an amalgamated company or group company that arise **after** amalgamation.
4. The provisions in subpart IE are closely aligned with the general rules on the carry-forward and grouping of tax losses. This means that the amalgamation rules do not allow a company to:
   - carry forward losses that would otherwise be lost; or
   - share its tax losses with a company that it would not otherwise be able to.
5. Subpart IE applies to tax losses including amounts of attributed controlled foreign company (CFC) and foreign investment fund (FIF) net losses on amalgamation.
6. To determine whether an amalgamated company can use a tax loss following an amalgamation, it is important that it maintain records tracking any tax loss components arising before the amalgamation.
7. For a detailed discussion of how the general loss rules apply, including carrying forward losses and sharing losses, see **IS 22/07**: **Company losses – ownership continuity, sharing and measurement**. Because this interpretation statement refers to several of the concepts discussed in IS 22/07, for ease of reference it summarises these concepts in the **appendix**.

Tax losses of an amalgamating company

Concessionary amalgamation

8. On a concessionary amalgamation, an amalgamating company's tax losses survive the amalgamation and are inherited by the amalgamated company if:
   - the amalgamating company meets one of the continuity tests to the date of amalgamation; and
   - **all** of the following companies were at least 66% commonly owned (ie, have commonality) from the start of the income year that the tax loss component arose to the date of amalgamation:
     - the amalgamating company that incurred the tax loss;
     - the amalgamated company, unless it was only incorporated on amalgamation; and
     - any other company that amalgamated with the amalgamated company.
9. An amalgamated company can use a tax loss inherited from an amalgamating company after amalgamation if:
   - continuity is met for the continuity period; and
   - commonality is met for the commonality period where the inherited tax loss is shared with a group company after amalgamation.
10. For the purpose of determining if ownership continuity and commonality are met, the amalgamated company is treated for all times before the amalgamation as if it did not separately exist and was instead the amalgamating company, with the same shareholders and option holders.
11. An amalgamated company might undertake a subsequent amalgamation before it uses a tax loss inherited from an amalgamating company on an earlier amalgamation. In this situation, the amalgamated company can only use the inherited tax loss if all of the following companies have commonality for the commonality period:
    - the amalgamating company that incurred the tax loss that the amalgamated company inherited; and
    - any company that amalgamated with the amalgamated company before it used the inherited tax loss.

Non-concessionary amalgamation

12. On a non-concessionary amalgamation, any tax losses of an amalgamating company that were not used before amalgamation are extinguished.

Tax losses of an amalgamated company

13. The treatment of an amalgamated company's tax losses arising before amalgamation depends on whether they are used in the pre-amalgamation part year or the post-amalgamation part year.
14. In the income year in which the amalgamation takes place, the pre-amalgamation part year is the part of the income year that ends with the date of amalgamation. The post-amalgamation part year is the part of the income year that begins on the day following the date of amalgamation and ends on the last day of the income year.

15. An amalgamated company can use its tax losses arising before the date of amalgamation in the pre-amalgamation part year if it meets:
    - continuity for the continuity period; and
    - commonality for the commonality period where the amalgamated company shares the tax loss with a group company.
16. Tax losses of an amalgamated company arising before amalgamation can be carried forward past the date of amalgamation if, from the start of the income year that the tax loss component arose to the date of amalgamation, the following requirements are met:
    - the amalgamated company meets a continuity test; and
    - the amalgamated company and any company that amalgamated with the amalgamated company are at least 66% commonly owned.
17. The final requirement is modified for a tax loss component that is an attributed CFC net loss or a FIF net loss. In these cases, the amalgamated and amalgamating companies must be in a wholly-owned group.

Tax losses of a non-amalgamating group company arising before amalgamation shared with an amalgamated company

18. The commonality requirement is modified where a non-amalgamating group company wants to share tax losses that arose before the date of amalgamation with an amalgamated company.
19. The tax loss can only be shared with the amalgamated company if **all** of the following companies have commonality for the commonality period:
    - the group company that incurred the tax loss;
    - the amalgamated company; and
    - any company that amalgamated with the amalgamated company.

Ordering

20. Tax loss components included in a tax loss must be used in the order that they arose.
21. An amalgamated company may have tax loss components for the same tax year. Where this occurs, the amalgamated company can notify the Commissioner of the order in which the losses are to be used. If no notification is made the losses must be used on a pro rata basis.

Introduction | Whakataki

22. The general tax loss rules are modified where companies amalgamate. The modifications apply to:
    - tax losses of an amalgamating company;
    - tax losses of an amalgamated company that arise before the amalgamation; and
    - tax losses of a group company that is not a party to the amalgamation where those losses arise before the amalgamation and are to be shared with an amalgamated company.
23. The provisions in subpart IE are closely aligned with the general rules on the carry-forward and grouping of tax losses. This means the concepts that are important in the context of the general loss rules (eg, “tax loss”, “tax loss component”, continuity and commonality) are also important in the context of an amalgamation.

Analysis | Tātari

24. This statement considers the provisions in subpart IE. Subpart IE applies to the tax losses of an amalgamated company, amalgamating company or non-amalgamating group company that arise **before** amalgamation.
25. Different rules apply depending on whether the tax losses are losses of an amalgamating company, an amalgamated company or a non-amalgamating group company. For this reason, this statement considers the tax losses of amalgamating companies, amalgamated companies and non-amalgamating group companies separately.

Tax losses of an amalgamating company

26. Where an amalgamating company has not used a tax loss before the date of amalgamation, the amalgamated company can use that tax loss after the amalgamation if the criteria in s IE 2 is met.

27. This section first considers when a tax loss of an amalgamating company is available to the amalgamated company (inherited). Second, it discusses when an amalgamated company can use an inherited tax loss after amalgamation.

When an amalgamated company inherits the tax loss of an amalgamating company

28. An amalgamated company inherits the tax loss of an amalgamating company if the amalgamating company:
    - meets a continuity test;
    - ends its existence on a concessionary amalgamation;
    - has a tax loss for a tax year that it has not used before the date of amalgamation; and
    - has a tax loss that could be made available and subtracted from the net income for the pre-amalgamation part year of:
        - the amalgamated company, unless it was only incorporated on amalgamation; and
        - any company that amalgamated with the amalgamated company.

29. Each requirement is discussed further below. Additional considerations for an amalgamated company using a tax loss inherited from an amalgamating company are discussed from [45].

Meets a continuity test

30. Section IE 2 applies only where an amalgamating company has a tax loss. An amalgamating company will only have a tax loss if it meets the ownership continuity test or the business continuity test. The appendix describes these tests from [A8].

Ends its existence on a concessionary amalgamation

31. Section IE 2 applies only to an amalgamating company that ends its existence on a concessionary amalgamation. For a discussion of the requirements for an amalgamation to be a concessionary amalgamation, see **IS 25/10**: **Income tax and GST – Amalgamations** from [13] to [19]. This statement discusses the tax treatment of an amalgamating company's tax losses on a non-concessionary amalgamation from [43].

Amalgamating company's tax loss has not been used before the date of amalgamation

32. Where an amalgamating company has not used a tax loss before the date of amalgamation, the amalgamated company can inherit that tax loss.

33. An amalgamating company might use a tax loss before the date of amalgamation. A loss balance carried forward to a tax year must first be used to reduce the net income (if any) of the company for the tax year.[1] Example | Tauira 1 illustrates an amalgamating company that uses some of its tax losses before the date of amalgamation.

34. An amalgamating company can use a tax loss in a few other ways. The main one is to share it with another company in the same group of companies. For information on this and the other ways of using a tax loss, see [43] in IS 22/07.

Able to share the tax loss with the amalgamated company and any other company that has amalgamated with the amalgamated company

35. An amalgamating company's tax loss must be one that "could" be made available and subtracted from the net income for the pre-amalgamation part year of:
    - the amalgamated company, unless it was only incorporated on amalgamation;[2] and
    - any other company that amalgamated with the amalgamated company.[3]

36. The focus is on the ability of the amalgamating company to share its losses in a general sense. The amount of tax loss an amalgamated company inherits is not limited to the amount of net income of the amalgamated company (or any company that amalgamated with the amalgamated company) in the pre-amalgamation part year.

1 Section IA 4(1).

2 Section IE 2(4).

3 Section IE 2(3).

37. Generally, an amalgamating company's tax loss could be made available if, from the start of the income year when the tax loss component arose to the date of amalgamation,[4] the following requirements are met:

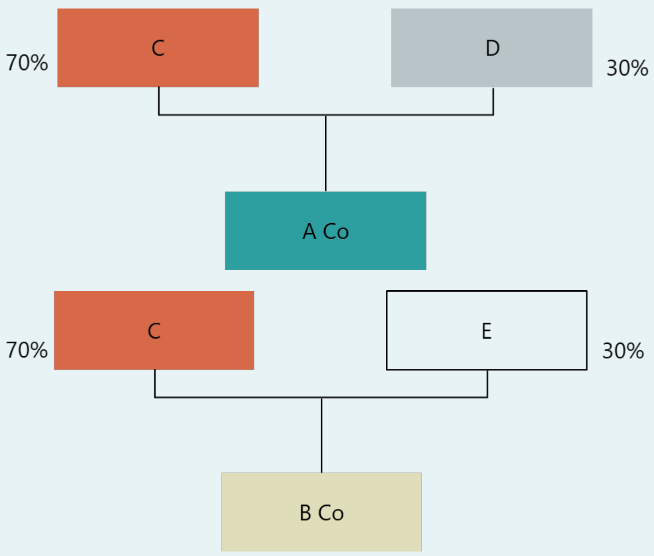
- the amalgamating company is either incorporated in New Zealand or carrying on a business in New Zealand through a fixed establishment in New Zealand;[5]
- the amalgamating company meets a continuity test; and
- **all** of the following companies are at least 66% commonly owned (ie, have commonality):[6]
    - the amalgamating company that incurred the tax loss;
    - the amalgamated company, unless it was only incorporated on amalgamation; and
    - any company that amalgamated with the amalgamated company.

38. Example | Tauira 1 illustrates a situation where an amalgamated company inherits the tax loss of an amalgamating company because it has the required commonality of ownership with the amalgamating company. Example | Tauira 2 illustrates a situation where an amalgamated company does not inherit the amalgamating company's tax loss because it does not have the required commonality of ownership with the amalgamating company.

Example | Tauira 1 – Amalgamated company inherits amalgamating company's tax loss

A Co and B Co amalgamate on 31 March 2024. A Co is the amalgamated company.

The shareholdings of A Co and B Co have been the same since incorporation and are as follows:



B Co has a tax loss carried forward to its 2024 income year of $100,000. The tax loss arose in B Co's 2023 income year.

B Co has net income in its 2024 income year of $50,000.

<u>B Co's use of its tax loss before the date of amalgamation</u>

B Co meets a continuity test (ie, ownership continuity) from the start of the income year when the tax loss component arose (1 April 2022) to the end of the 2024 income year (31 March 2024).

B Co must use $50,000 of the tax loss carried forward of $100,000 to offset its net income in the 2024 income year.

4 Subject to the application of the part-year rules.

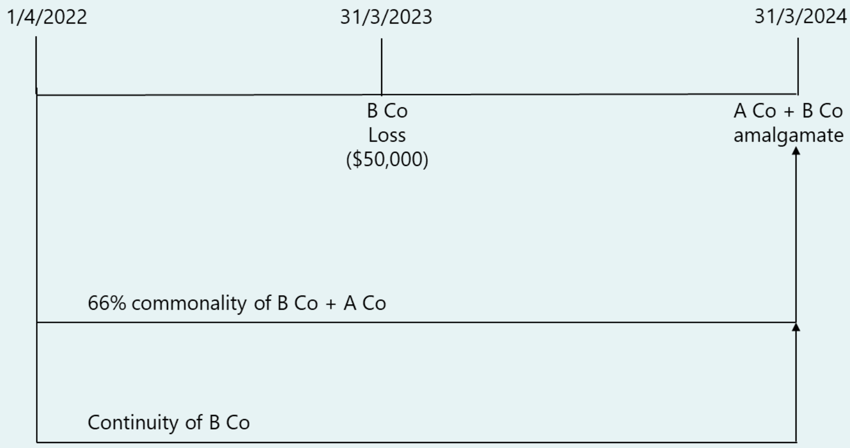
5 Sections IC 5(1)(b) and IC 7. For further information on this requirement, see [62] to [67] of IS 22/07.

6 Sections IC 2, IE 2(1)(b) and IE 2(3).

Inheriting tax loss

The tax loss of B Co that it does not use before the date of amalgamation is $50,000.

A Co will inherit B Co's remaining tax loss balance of $50,000 if B Co meets a continuity test and A Co and B Co are at least 66% commonly owned from the start of the income year when the tax loss component arose (1 April 2022) until the date of amalgamation (31 March 2024). The diagram below shows the continuity and commonality tests required to be met.



Based on the shareholdings of A Co and B Co above, A Co and B Co were at least 66% commonly owned (A Co and B Co were 70% commonly owned) and B Co met a continuity test. A Co inherits B Co's tax loss of $50,000.

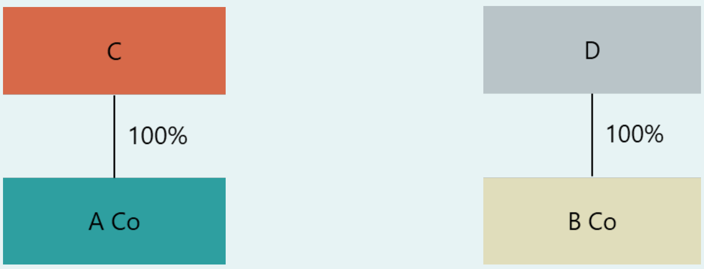
Shareholder	A Co (1 April 2022 to 31 March 2024)	B Co (1 April 2022 to 31 March 2024)	Commonality of voting interests
C	70%	70%	70%
D	30%	0%	0%
E	0%	30%	0%
			70%

Example | Tauira 2 – Amalgamated company does not inherit the amalgamating company's tax losses

A Co and B Co amalgamate on 31 March 2024. A Co is the amalgamated company.

A Co acquired 100% of the shares in B Co on 1 April 2023.

Before 1 April 2023, the shareholdings of A Co and B Co were as follows:



At the date of amalgamation, B Co has tax losses of $75,000. The tax losses arose in the 2022 income year and B Co carries them forward on the basis that it meets the business continuity test.

A Co and B Co are 100% commonly owned from 1 April 2023 to the date of amalgamation. However, based on the shareholdings above, A Co and B Co were not at least 66% commonly owned from the start of the income year when the tax loss component arose (1 April 2021) until 31 March 2023 (A Co and B Co had no common ownership). It follows that A Co does not inherit B Co's tax loss on amalgamation.

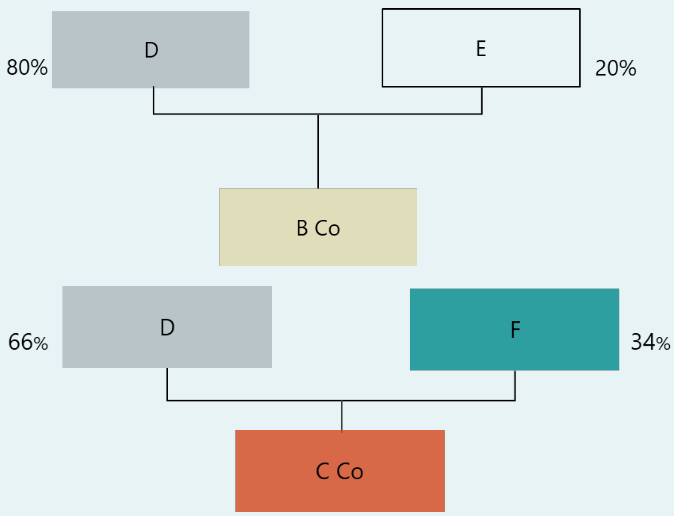
Shareholder	A Co (1 April 2021 to 31 March 2023)	B Co (1 April 2021 to 31 March 2023)	Commonality of voting interests
C	100%	0%	0%
D	0%	100%	0%
			0%

39. An amalgamated company that is incorporated only on amalgamation does not need to have commonality with the amalgamating company that incurred the tax loss. However, if the amalgamation involves more than one amalgamating company, the amalgamating company that incurred the loss must have commonality with the other company or companies that amalgamated with the amalgamated company. Example | Tauira 3 illustrates an amalgamation where the amalgamated company is incorporated only on amalgamation.

Example | Tauira 3 – Amalgamating company's tax losses inherited by an amalgamated company that is incorporated only on amalgamation

B Co and C Co amalgamate on 31 March 2024. The amalgamated company (A Co) is a new company incorporated on amalgamation.

The shareholdings of B Co and C Co have been the same since incorporation and are as follows:



At the date of amalgamation, B Co has tax losses of $10,000. The tax losses arose in B Co's 2022 income year.

Based on the shareholdings of B Co and C Co above, B Co and C Co were at least 66% commonly owned (B Co and C Co were 66% commonly owned) from the start of the income year that the tax loss component arose (1 April 2021) until the date of amalgamation (31 March 2024). Accordingly, A Co inherits B Co's tax loss of $10,000.

Shareholder	B Co (1 April 2021 to 31 March 2024)	C Co (1 April 2021 to 31 March 2024)	Commonality of voting interests
D	80%	66%	66%
E	20%	0%	0%
F	0%	34%	0%
			66%

40. Sometimes an amalgamated company undertakes multiple separate amalgamations. In this case, the requirements go beyond the 66% commonality of ownership between the amalgamating company and amalgamated company described at [37]. Specifically, there must also be 66% commonality of ownership between the amalgamating company that incurred the loss and any other company that amalgamated with the amalgamated company before or on the date of amalgamation.

41. Example | Tauira 4 illustrates the continuity and commonality tests that must be met for an amalgamated company to inherit the tax loss of an amalgamating company where the amalgamated company has undertaken multiple amalgamations.

Example | Tauira 4 – Inheriting an amalgamating company's tax loss when the amalgamated company has undertaken multiple amalgamations

A Co and B Co amalgamate on 31 March 2024. A Co is the amalgamated company.

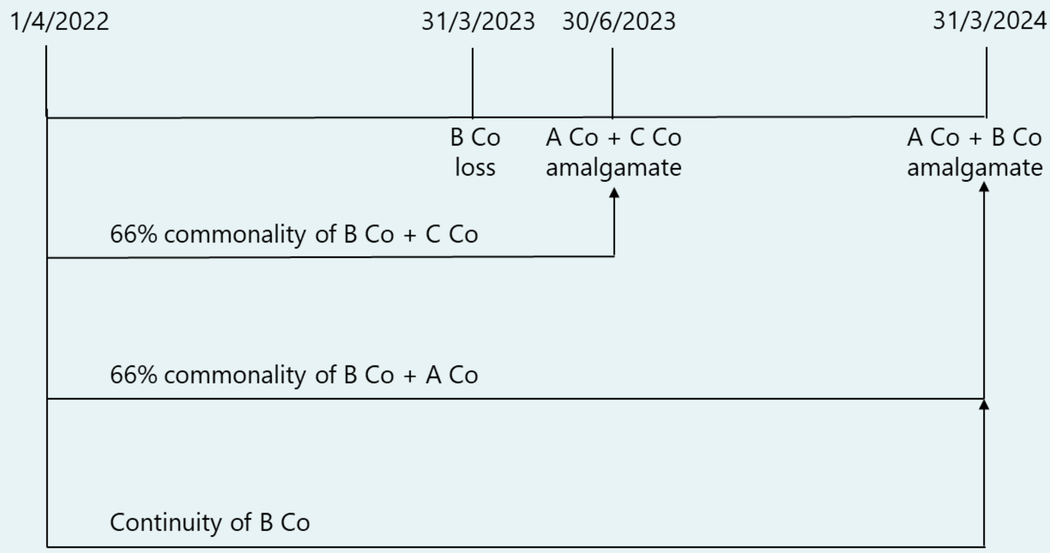
B Co has a tax loss that arose in the year ended 31 March 2023. A Co wants to know if it will inherit B Co's tax loss.

A Co will inherit B Co's tax loss if from the start of the income year that the tax loss component arose (1 April 2022) to the date of amalgamation (31 March 2024):

- B Co meets a continuity test; and
- A Co, B Co and any other company A Co amalgamated with are at least 66% commonly owned.

A Co undertook an earlier amalgamation. A Co amalgamated with C Co on 30 June 2023. A Co was the amalgamated company. It follows that A Co, B Co and C Co must be at least 66% commonly owned in the period from 1 April 2022 to 31 March 2024 if A Co is to inherit B Co's tax loss.

The diagram below shows the continuity and commonality tests required to be met.



42. Sometimes the continuity or commonality test will be satisfied for part of an income year only (as opposed to from the start of the income year when the loss component arose). The outcome is that the amalgamated company might inherit some but not all of the amalgamating company's tax losses. Example | Tauira 5 illustrates a situation where an amalgamating company and amalgamated company have commonality for part of an income year only.

Example | Tauira 5 – Commonality met part-way through an income year

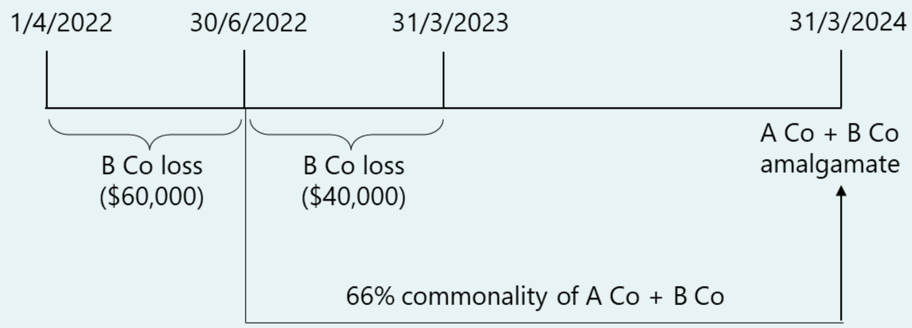
A Co and B Co amalgamate on 31 March 2024. A Co is the amalgamated company.

At the date of amalgamation, B Co had unused tax losses carried forward from the 2023 income year of $100,000.

Since incorporation, C has had 100% ownership of A Co.

From the date of incorporation to 30 June 2022, C held 50% of the shares in B Co and D held the other 50%. On 30 June 2022, C increased their shareholding in B Co to 70%. That is, A Co and B Co were at least 66% commonly owned from 30 June 2022.

B Co determines that $40,000 of its net loss of $100,000 arose in the part of the year when A Co and B Co were commonly owned (ie, from 30 June 2022 to 31 March 2023).



A Co inherits the part of B Co's tax loss ($40,000) that arose in the period where A Co and B Co were at least 66% commonly owned.

Non-concessionary amalgamation

43. As discussed at [28], one of the requirements that must be met for an amalgamated company to inherit an amalgamating company's tax loss is that the amalgamating company ends its existence on a concessionary amalgamation.

44. The tax losses of an amalgamating company on a non-concessionary amalgamation are extinguished. Example | Tauira 6 illustrates what happens to the tax losses of an amalgamating company on a non-concessionary amalgamation.

Example | Tauira 6 – Extinguishment of an amalgamating company's tax loss on a non-concessionary amalgamation

A Co and B Co amalgamate on 30 June 2024. A Co is the amalgamated company.

The companies notify the Commissioner of their decision to treat the amalgamation as a non-concessionary amalgamation.

B Co incurs a tax loss of $2,000 in its 2024 income year that it cannot use before the date of amalgamation. A Co does not inherit B Co's tax loss of $2,000 because the amalgamation is a non-concessionary amalgamation.

Amalgamated company using an inherited tax loss

45. The general tax loss rules set out how a company can use a tax loss. They contain specific rules and concessions on measuring the continuity of ownership (eg, notional single person).

46. Section IE 2 modifies how these rules apply where an amalgamated company inherited the tax loss from an amalgamating company on a concessionary amalgamation.[7]

47. To determine whether an amalgamated company meets the ownership continuity and commonality tests so that it can use the tax loss, or the tax loss can be subtracted from the net income of a group company after amalgamation, the amalgamated company is treated for all times before the amalgamation as if it did not separately exist and was instead the amalgamating company, with the same shareholders and option holders.

48. The following paragraphs set out how s IE 2 applies in each situation and include examples.

7 See ss IE 2(2) and IE 5.

Continuity test

49. Generally, an amalgamated company can use an inherited tax loss if it meets a continuity test from the start of the income year that the tax loss component arose until the end of the income year in which it is to use the loss.[8] Where the inherited tax loss was carried forward by the amalgamating company under the business continuity test, the amalgamated company must also meet the business continuity test. This statement does not consider the business continuity test requirements. For guidance on the main aspects of the business continuity test, see **IS 22/06: Loss carry-forward – continuity of business activities**.

50. For the purposes of the Act the amalgamated company is treated for all times before the amalgamation as if it did not separately exist and was instead the amalgamating companies, with the same shareholders and option holders. This means that from the start of the income year when the tax loss component arose to the date of amalgamation, ownership continuity is considered based on the shareholding of the amalgamating company. From the date of amalgamation to the end of the income year in which the loss is used, ownership continuity is considered in relation to the shareholding of the amalgamated company.

51. Example | Tauira 7 illustrates how the ownership continuity test applies to an amalgamated company wanting to use a tax loss it inherits from an amalgamating company to offset net income arising after amalgamation.

52. If an amalgamated company inherits tax losses of one or more amalgamating companies, the losses of each amalgamating company need to be tracked separately to determine if the amalgamated company meets the continuity requirement for the relevant continuity period.

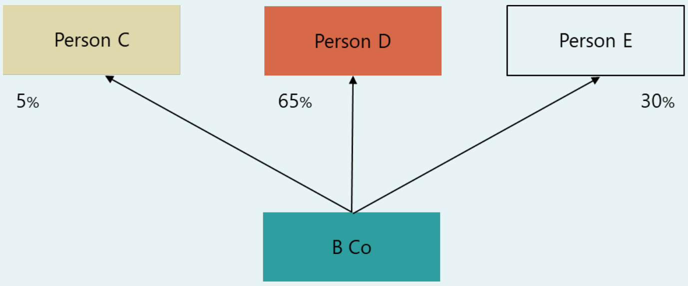
Example | Tauira 7 – Ownership continuity of amalgamated company after an amalgamation

A Co and B Co amalgamate on 31 March 2023. A Co is the amalgamated company.

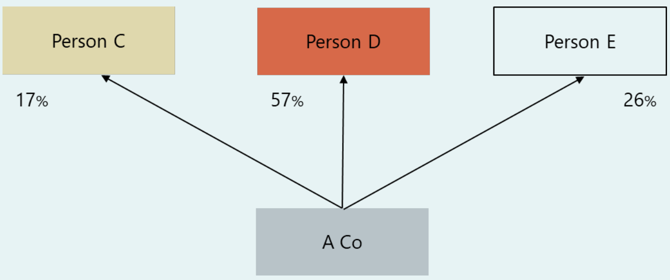
B Co incurred a $50,000 loss in the 2022 income year that it carried forward to the 2023 income year.

The commonality of ownership test was met at the date of amalgamation and A Co inherited the tax loss of B Co. A Co now wishes to use the tax loss to offset its net income derived in the 2024 income year.

The shareholding of B Co from the start of the income year in which the loss arose (1 April 2021) to the date of amalgamation (31 March 2023) was as follows:



The shareholding of A Co from the date of amalgamation to the end of the 2024 income year (31 March 2024) was as follows:



A Co can use the tax loss inherited from B Co if it meets a continuity test from the start of the income year in which the loss arose (1 April 2021) to the date when it will use the loss (31 March 2024).

8 Subject to application of the part-year rules.

INTERPRETATION STATEMENTS

To determine ownership continuity, A Co is treated as if it had B Co's shareholders before the amalgamation and its own shareholders after the amalgamation.

Shareholder	1 April 2021 to 31 March 2023	1 April 2023 to 31 March 2024	Continuity of voting interest
C	5%	17%	5%
D	65%	57%	57%
E	30%	26%	26%
			88%

Because ownership continuity is maintained, A Co:

- does not need to consider the business continuity test; and
- can use the tax loss inherited from B Co to offset its net income in the 2024 income year.

Notional single person

53. Sometimes the shareholding of an amalgamating company and an amalgamated company includes ownership interests of less than 10% in a company that are treated as held by a "notional single person".[9] The notional single person rule allows smaller ownership interests to be tracked together as a group. It applies where a person:
    - has a direct ownership interest in a company of less than 10%; and
    - is not a company that is associated with the subject company.
54. For further information on the notional single person rule, see [165] to [178] of IS 22/07.
55. If the shareholdings of an amalgamating company and an amalgamated company each include a notional single person, the notional single person in the amalgamating company and the notional single person in the amalgamated company are treated as the same person after the amalgamation when calculating ownership continuity.[10] Example | Tauira 8 illustrates how this works.

Example | Tauira 8 – Ownership continuity where the amalgamating company and amalgamated company have a notional single person

A Co and B Co amalgamate on 31 March 2024. A Co is the amalgamated company.

A Co and B Co both have several shareholders who each hold an ownership interest of less than 10% in the company. The company treats them as a notional single person.

The shareholdings of A Co and B Co are as follows:

Shareholder	B Co (to 31 March 2024)	A Co (on 1 April 2024)	Continuity of voting interest
C	15%	45%	15%
D	45%	20%	20%
Notional single person	40%	35%	35%
			70%

9 Section YC 10.

10 The notional single person rule does not apply when determining if commonality is satisfied.

Subsequent amalgamations

56. An amalgamated company might undertake a subsequent amalgamation before it uses a tax loss it inherited from an amalgamating company on an earlier amalgamation.

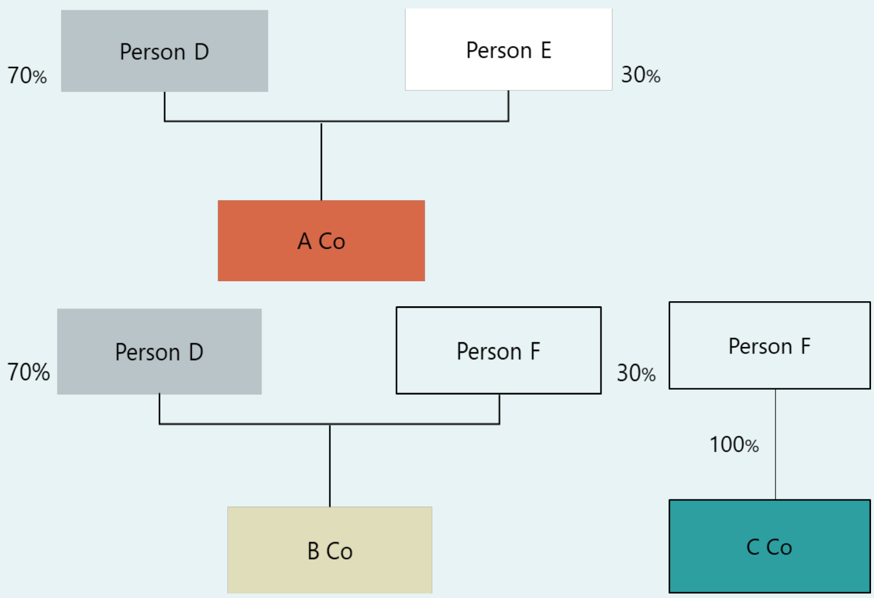
57. In this situation, an amalgamated company can only use the inherited tax loss if all the following companies are at least 66% commonly owned for the commonality period:
    - the amalgamating company that incurred the tax loss inherited by the amalgamated company; and
    - any company that amalgamated with the amalgamated company before the amalgamated company can use the inherited tax loss.

58. Example | Tauira 9 illustrates a situation where an amalgamated company is unable to use an inherited tax loss because the amalgamating company that incurred the tax loss did not have the required commonality with a company that amalgamated with the amalgamated company before it was able to use the loss.

Example | Tauira 9 – Where an amalgamated company cannot use an inherited tax loss following a subsequent amalgamation

A Co and B Co amalgamate on 1 April 2022. A Co amalgamates with C Co on 1 September 2022. A Co is the amalgamated company in each amalgamation.

The shareholdings of A Co, B Co and C Co remained unchanged since incorporation and are as follows:



B Co incurred a loss in the year ended 31 March 2021 that A Co inherited on amalgamation on the basis that:

- B Co met the ownership continuity test; and
- A Co and B Co were at least 66% commonly owned from the start of the income year when the tax loss arose until the amalgamation date.

A Co derives net income in the 2024 income year.

A Co cannot use the tax loss it inherited from B Co on amalgamation to offset against its net income in the 2024 income year. Based on the shareholdings of B Co and C Co above, B Co and C Co were not at least 66% commonly owned from the start of the income year in which the loss arose (1 April 2020) to the amalgamation date (1 September 2022). B Co and C Co were only 30% commonly owned.

Shareholder	B Co (1 April 2020 to 1 September 2022)	C Co (1 April 2020 to 1 September 2022)	Commonality of voting interests
D	70%	0%	0%
E	0%	0%	0%
F	30%	100%	30%
			30%

Sharing an amalgamated company's inherited loss with a group company after amalgamation

59. Under the general tax loss rules, a loss company[11] can share a tax loss with a profit company if:
    - the loss company is either incorporated in New Zealand or carrying on a business in New Zealand through a fixed establishment in New Zealand;
    - notification and payment requirements are met;[12]
    - the loss company meets a continuity requirement;[13] and
    - the profit company and the loss company meet ownership commonality requirements.[14]

60. For a detailed discussion of the requirements under the general tax loss rules that companies need to meet in order to share losses, see [60] to [112] of IS 22/07.

61. To determine if the required commonality of ownership is met where the loss company is an amalgamated company and the tax loss being shared is an inherited tax loss, the amalgamated company is treated in respect of the inherited loss as if it had the amalgamating company's shareholders before the date of amalgamation and its own shareholders from the date of amalgamation. Example | Tauira 10 illustrates how this works.

11 For the purpose of this statement the terms "loss company" means a company that has a tax loss component that it can use, and "profit company" means a company that has net income.

12 See ss IC 8 and IC 9.

13 See s IC 2(1).

14 See s IC 2(2).

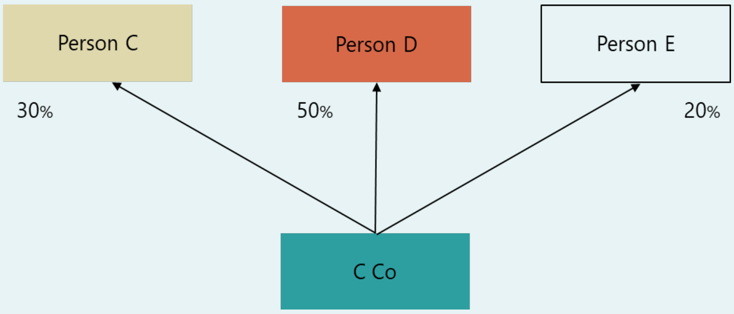
Example | Tauira 10 – Amalgamated company offsetting inherited tax loss against net income of a company that was not involved in the amalgamation

In Example | Tauira 7 A Co amalgamated with B Co on 31 March 2023.

A Co (the amalgamated company) inherited B Co's tax loss on amalgamation and used the tax loss to offset its net income derived in the 2024 income year.

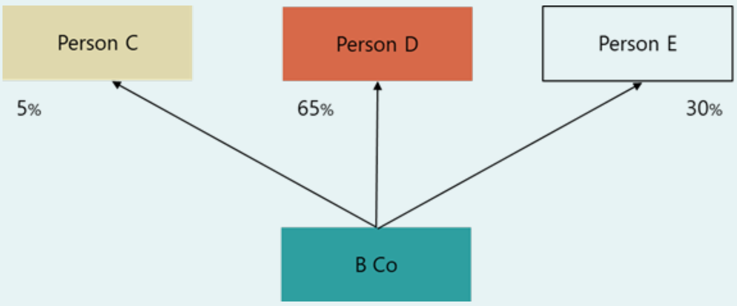
Assume that A Co from Example | Tauira 7 had no net income in the 2024 income year and instead seeks to offset the tax loss inherited from B Co against C Co's net income (a non-amalgamating group company) in the 2024 income year.

The shareholding of C Co has not changed since it was incorporated and is as follows



For A Co to offset the losses it inherited from B Co against net income of C Co arising after the date of amalgamation, A Co and C Co must be at least 66% commonly owned from the start of the income year in which the loss arose (1 April 2021) until the end of C Co's 2024 income year (31 March 2024).

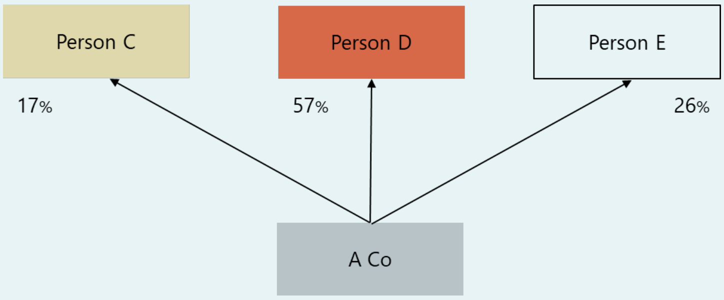
In measuring the commonality of shareholding between A Co and C Co to the date of amalgamation, A Co's shareholding is based on the shareholding of B Co. As discussed at Example | Tauira 7, the shareholding of B Co from the start of the income year in which the loss arose (1 April 2021) to the date of amalgamation is as follows:



Shareholder	B Co (1 April 2021 to 31 March 2023)	C Co (1 April 2021 to 31 March 2023)	Commonality of voting interest
C	5%	30%	5%
D	65%	50%	50%
E	30%	20%	20%
			75%

As B Co and C Co meet the commonality test from the start of the income year in which B Co incurred the loss to the date of amalgamation, the commonality test must next be applied to the shareholding of A Co after the amalgamation.

As discussed at Example | Tauira 7 above, the shareholding of A Co from the date of amalgamation to the end of the 2024 income year (31 March 2024) is as follows:



Shareholder	A Co (1 April 2023 to 31 March 2024)	C Co (1 April 2023 to 31 March 2024)	Commonality of voting interest
C	17%	30%	17%
D	57%	50%	50%
E	26%	20%	20%
			87%

As the commonality test is met before and after amalgamation, A Co can offset the net income of C Co against the losses A Co inherited from B Co on amalgamation.

Tax losses of an amalgamated company

62. Section IE 3 applies to an amalgamated company in relation to either or both of the following (referred to in this item as the pre-amalgamation loss):
    - a tax loss balance carried forward to the year of amalgamation for which a continuity test is met up to the date of amalgamation; and/or
    - the part of the net loss in the amalgamation tax year that relates to the pre-amalgamation part year.
63. Tax losses of an amalgamated company arising **after** amalgamation are considered under the general tax loss rules.
64. This section applies to the tax losses of an amalgamated company on a concessionary amalgamation and a non-concessionary amalgamation.

Pre-amalgamation part year and post-amalgamation part year

65. For the purposes of s IE 3 only, the year of amalgamation is treated as two separate tax years. The pre-amalgamation part year is the part of the income year that ends with the date of amalgamation. The post-amalgamation part year is the part of the income year that begins on the day following the date of amalgamation and ends on the last day of the income year. For example, an amalgamated company has a standard balance date (31 March) and amalgamates on 30 June 2023. The pre-amalgamation part year is the period that starts on 1 April 2023 and ends on 30 June 2023. The post-amalgamation part year is the period that starts on 1 July 2023 and ends on 31 March 2024.
66. Sometimes an amalgamation will take place at the end of the income year such that the pre-amalgamation part year is the entire income year. For example, an amalgamated company has a standard balance date (31 March) and amalgamates on 31 March 2024. The pre-amalgamation part year is the period that starts on 1 April 2023 and ends on 31 March 2024.
67. How s IE 3 applies to the pre-amalgamation part year and post-amalgamation part year is discussed further from [69].
68. Treating the year of amalgamation as two separate years for the purposes of s IE 3 does not mean that the amalgamated company needs to file two separate income tax returns for the year of amalgamation. An amalgamated company continues to calculate its taxable income in the year of amalgamation in accordance with subpart BC (of the core provisions in Part B).

Pre-amalgamation tax losses used or made available in the pre-amalgamation part year (s IE 3(2))

69. An amalgamated company that has net income in the year of amalgamation may have a tax loss balance carried forward to the year of amalgamation. In this situation where the amalgamated company meets a continuity test up to the date of amalgamation, the tax loss must first be subtracted from the part of the net income that relates to the pre-amalgamation part year.[15] Example | Tauira 14 illustrates a situation where an amalgamated company uses part of its pre-amalgamation losses in the pre-amalgamation part year.

70. The amalgamated company may make any unused tax loss balance available to a group company for subtraction from the part of the group company's net income in the amalgamation tax year that relates to the pre-amalgamation part year. This applies provided the commonality test under the general loss grouping rules is met.[16]

71. Similarly, if the amalgamated company has a net loss in the year of amalgamation, it may share the part of the net loss that relates to the pre-amalgamation part year with a group company and subtract it from the part of the group company's net income in the amalgamation tax year that relates to the pre-amalgamation part year. This applies provided the commonality test under the general loss grouping rules is met.

Pre-amalgamation tax losses used or made available after amalgamation (s IE 3(3))

72. A pre-amalgamation loss of an amalgamated company not used or made available in the pre-amalgamation part year may only be carried forward past the date of amalgamation (to the post-amalgamation part year), if both of the following requirements are met:
    - the amalgamated company meets a continuity test from the start of the income year in which the loss arose to the date of amalgamation; and
    - the pre-amalgamation loss could have been made available to an amalgamating company and subtracted from its net income calculated for the pre-amalgamation part year.

73. As discussed at [36], the second requirement is focused on the ability of an amalgamated company to share its pre-amalgamation losses with the amalgamating companies in a general sense. It follows that the amalgamating company is not required to have net income for the pre-amalgamation part year against which it could, in fact, have offset the amalgamated company's pre-amalgamation loss.

74. An amalgamated company could make its tax loss available to an amalgamating company to offset against its net income for the pre-amalgamation part year if, from the start of the income year that the tax loss component arose to the date of amalgamation, the following requirements are met:
    - the amalgamated company is either incorporated in New Zealand or carrying on a business in New Zealand through a fixed establishment in New Zealand;[17]
    - the amalgamated company meets a continuity test; and
    - the amalgamated company and any company that amalgamated with it are at least 66% commonly owned.

75. The final requirement is modified for a tax loss component that is an attributed controlled foreign company (CFC) net loss or a foreign investment fund (FIF) net loss. In these cases, the amalgamated and amalgamating companies must be in a wholly owned group.

76. Example | Tauira 11 illustrates a situation where an amalgamated company is able to use a pre-amalgamation tax loss to offset net income arising after the amalgamation because the amalgamated company and amalgamating company were at least 66% commonly owned. Example | Tauira 12 discusses a situation where the amalgamated company's pre-amalgamation losses carried forward under the business continuity test are sought to be used after the amalgamation. Example | Tauira 13 illustrates a situation where an amalgamated company cannot use a pre-amalgamation tax loss to offset net income arising after the amalgamation because the amalgamated and amalgamating companies were not at least 66% commonly owned when the pre-amalgamation tax loss arose. Example | Tauira 14 illustrates the different tests that apply to pre-amalgamation tax losses used before and after amalgamation.

15 See ss IE 3(2) and IA 4(1).

16 See s IE 3(2).

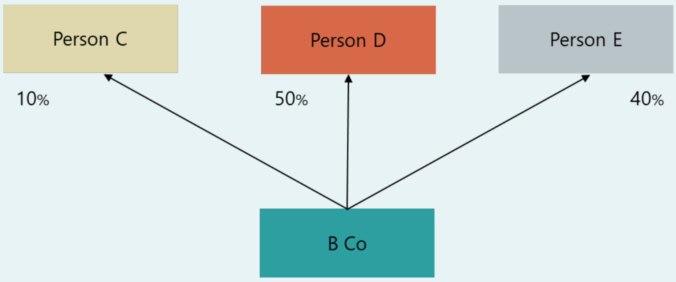
17 Sections IC 5(1)(b) and IC 7. For further information on this requirement, see [62] to [67] of IS 22/07.

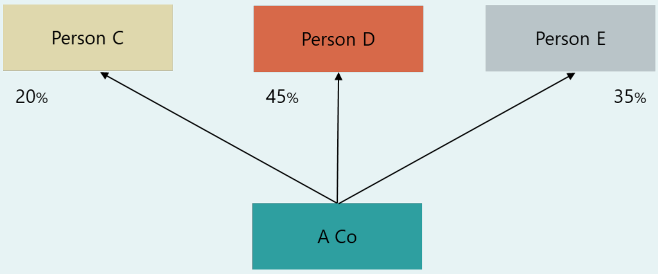
Example | Tauira 11 – Amalgamated company using its pre-amalgamation tax loss to offset net income arising after the amalgamation

A Co and B Co amalgamate on 31 March 2023. A Co is the amalgamated company.

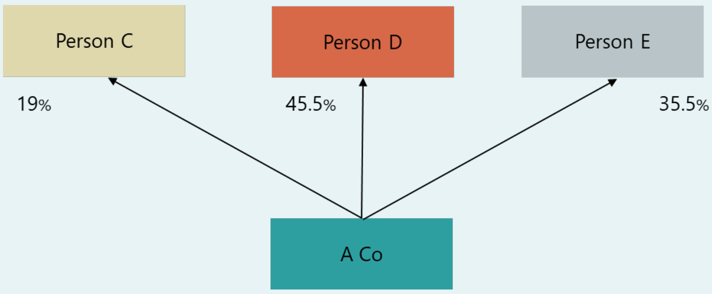
A Co incurred a loss of $30,000 in the year ended 31 March 2022, was in a breakeven position in the year ended 31 March 2023 and derived net income in the year ended 31 March 2024 of $40,000.

Prior to the amalgamation the shareholdings of each company (unchanged since incorporation) were as follows:





After the amalgamation, the shareholding in A Co is as follows



A Co can offset its tax loss that arose before the amalgamation (the 2022 income year) against its net income arising after the amalgamation (the 2024 income year) if the continuity and commonality tests are met.

<u>Continuity of shareholding</u>

Based on the shareholdings above, A Co meets the ownership continuity test from the start of the income year in which the loss arose (1 April 2021) to the date the loss is used (31 March 2024).

Shareholder	**A Co (1 April 2021)**	**A Co (31 March 2024)**	**Continuity of voting interest**
C	20%	19%	19%
D	45%	45.5%	45%
E	35%	35.5%	35%
			99%

Commonality of shareholding

Based on the shareholdings above, A Co and B Co were at least 66% commonly owned from the beginning of the year in which the loss arose until the date of amalgamation (A Co and B Co were 90% commonly owned). Accordingly, A Co can offset its pre-amalgamation tax loss against its net income in the 2024 income year.

Shareholder	B Co (1 April 2021 to 31 March 2023)	A Co (1 April 2021 to 31 March 2023)	Commonality of voting interest
C	10%	20%	10%
D	50%	45%	45%
E	40%	35%	35%
			90%

Example | Tauira 12 – Amalgamated company's pre-amalgamation losses carried forward under the business continuity test are sought to be used after the amalgamation

A Co and B Co (both New Zealand resident companies) have had common ownership since they were incorporated. A Co manufactures footwear which is sold to customers by B Co.

A Co incurred a $10,000 loss in its 2022 income year that it carried forward to its 2024 income year based on the business continuity test (following a 100% change in the shareholding of both A Co and B Co on 31 March 2022).

A Co and B Co amalgamate on 31 March 2023. A Co is the amalgamated company. The amalgamation did not result in any major changes to A Co's core business processes (which remained the manufacture and sale of footwear), the type of products manufactured, the assets utilised in the business or the scale of the business.

A Co seeks to offset the $10,000 loss against its net income arising in the 2024 income year.

Under s IE 3, A Co can carry forward its 2022 losses past the date of amalgamation on the basis that:

- it meets a continuity test from the start of the income year in which the loss arose to the date of amalgamation; and
- the pre-amalgamation loss of $10,000 could have been made available to B Co and subtracted from its net income in the year of amalgamation (as A Co and B Co were at least 66% commonly owned from the start of the income year in which the loss arose (1 April 2021) to the date of amalgamation (31 March 2023)).

A Co can use its 2022 tax loss to offset its net income arising in the 2024 income year if it continues to satisfy the business continuity test under subpart IB.

Before the amalgamation A Co and B Co were treated as a single company for the purposes of applying subpart IB 3 on the basis that they are both New Zealand resident companies and were part of the same group of companies immediately before and immediately after the ownership continuity breach (on 31 March 2022). The nature of the business activities carried on by the deemed single company was the manufacture and sale of footwear.

A Co can offset the loss against its income arising in the 2024 income year on the basis that there has been no major change to the nature of its business activities from the start of the income year in which the loss arose to the end of its 2024 income year. During this period the same business activities have been carried on (before amalgamation by A Co and B Co and after amalgamation, by A Co) using the same business processes, assets and operations.

Example | Tauira 13 – Amalgamated company cannot use pre-amalgamation tax losses following an amalgamation with a subsidiary that was incorporated after the tax loss components arose

A Co amalgamates with its wholly owned subsidiary B Co on 31 March 2023. A Co is the amalgamated company.

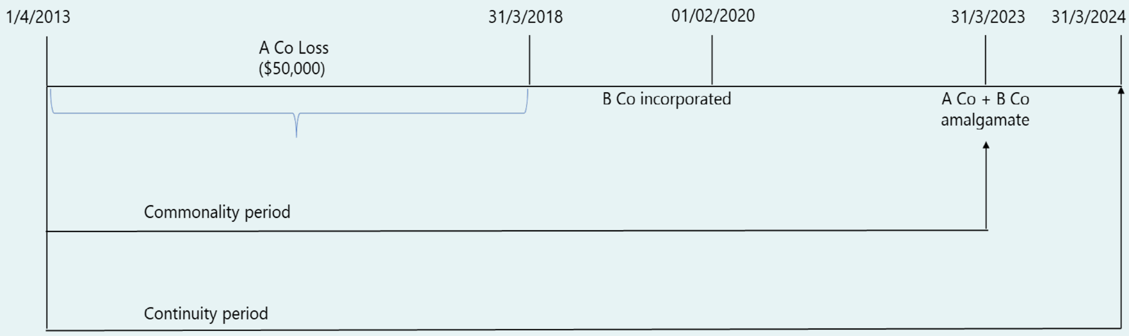
A Co has had the same shareholding since incorporation.

At the end of its 2023 income year (31 March 2023), A Co has a tax loss balance of $50,000. The losses arose in the 2014 to 2018 income years.

B Co was incorporated during the 2020 income year (1 February 2020) for the purpose of protecting a name for a business opportunity that A Co was considering. The business never eventuated, and A Co decided to amalgamate with B Co as part of tidying its corporate structure.

A Co has net income in its 2024 income year that it wants to offset against its losses of $50,000.

It can offset its net income arising after the amalgamation if the continuity and commonality tests illustrated below are met.



A Co cannot use its pre-amalgamation losses after the amalgamation with B Co as A Co and B Co were not commonly owned at the time that A Co's losses arose. B Co was not incorporated until after A Co's losses arose.

Example | Tauira 14 – Pre-amalgamation losses used before and after amalgamation

A Co and B Co (both of which have a 31 March balance date) amalgamate on 30 June 2023. A Co is the amalgamated company.

The shareholding of A Co has remained unchanged since incorporation. A Co and B Co were 100% commonly owned from 1 April 2022. Prior to this date A Co owned 30% of B Co's shares.

A Co derives net income in the year of amalgamation (year ended 31 March 2024) of $35,000. A Co is working out if its pre-amalgamation losses can be offset against its net income in the year of amalgamation.

A Co's loss balances are as follows:

Year ending	31 March 2021	31 March 2022	31 March 2023
A Co			
Tax loss component by year	($10,000)	($5,000)	($20,000)
Loss balance at year end	($10,000)	($15,000)	($35,000)

In the year of amalgamation, A Co's net income in the pre-amalgamation part year and post-amalgamation part year is as follows:

	Pre-amalgamation net income	Post-amalgamation net income	Net income for 2024 income year
A Co	$10,000	$25,000	$35,000

A Co's pre-amalgamation losses can be used to offset the net income arising in the pre-amalgamation part year (treating the pre-amalgamation part year as if it were a separate tax year) if a continuity test is met.

As ownership continuity is met A Co can offset its pre-amalgamation loss against its net income in the pre-amalgamation part year of $10,000 (as shown in the table above).

A Co's earliest tax loss is from the 2021 income year. The tax loss component in the 2021 income year happens to equal the amount of the A Co's net income in the pre-amalgamation part year of $10,000, so is fully used.

A Co's remaining pre-amalgamation loss is as follows:

Year ending	31 March 2021	31 March 2022	31 March 2023
A Co			
Loss balance at year end	($10,000)	($5,000)	($25,000)
Use of tax losses prior to amalgamation	$10,000	-	-
Remaining tax loss	-	(5,000)	($25,000)

The balance of A Co's pre-amalgamation losses can only be used after amalgamation if the pre-amalgamation losses could have been subtracted from B Co's net income calculated for the pre-amalgamation part year. As A Co and B Co were only at least 66% commonly owned from 1 April 2022 (the start of the 2023 income year), A Co's tax loss component arising in the 2022 income year ($5,000) cannot be used by A Co to offset its net income, or net income of a group company, after the amalgamation.

As A Co and B Co meet the commonality test in relation to A Co' tax loss component arising in the 2023 income year ($20,000), those losses can be used to offset (in part) A Co's net income arising in the post-amalgamation part year ($25,000).

Sharing a non-amalgamating group company's loss arising in the pre-amalgamation part year with an amalgamated company after amalgamation

77. The general tax rules as to when a loss company can share a tax loss with a profit company are discussed at [59].[18] A further requirement must be met where a non-amalgamating group company wants to share tax losses that arose before the date of amalgamation with an amalgamated company after amalgamation.

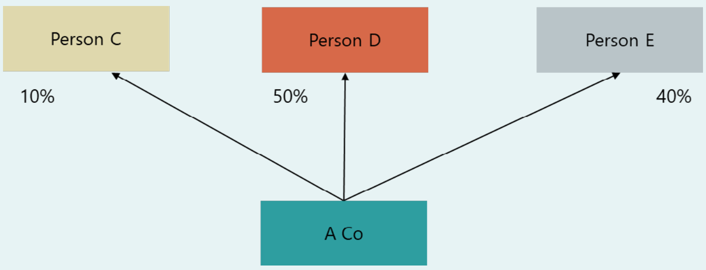
78. The tax loss can only be shared with the amalgamated company if **all** of the following companies have commonality for the commonality period:[19]
    - the group company that incurred the tax loss;
    - the amalgamated company; and
    - any company that amalgamated with the amalgamated company.

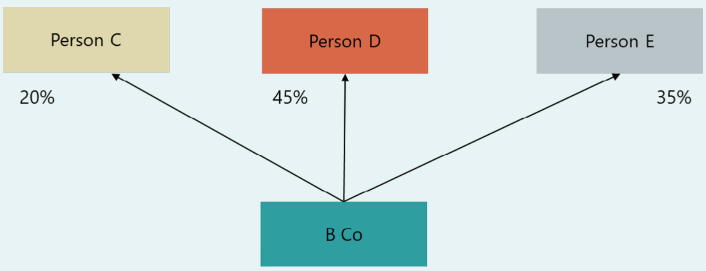
79. Example | Tauira 15 illustrates where the tax loss of a non-amalgamating group company arising before amalgamation could be offset against the net income of an amalgamated company because the non-amalgamating group company, amalgamated company and the amalgamating company were at least 66% commonly owned.

Example | Tauira 15 – Non-amalgamating group company offsets tax losses arising before amalgamation

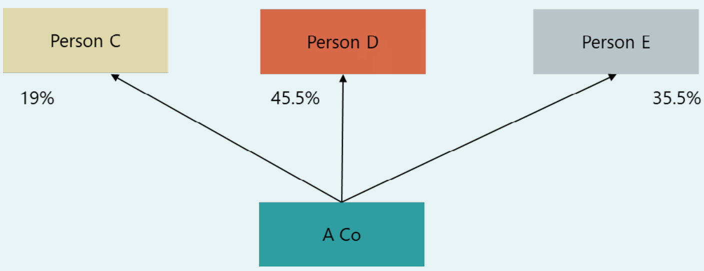
A Co and B Co amalgamate on 31 March 2023. A Co is the amalgamated company.

The shareholdings of each company have remained unchanged since incorporation and are as follows:





After the amalgamation, the shareholding of A Co is as follows:

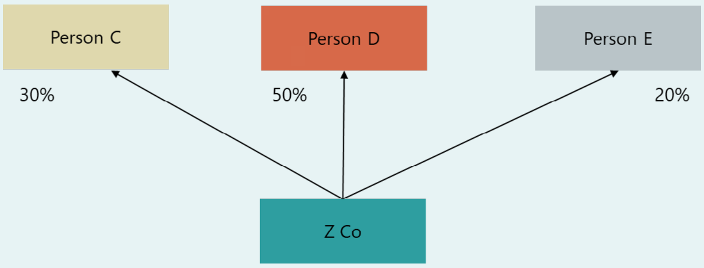


Z Co (a non-amalgamating group company) has losses from the 2022 income year, which it wants to offset against the net income of A Co in the 2024 income year.

18 Different rules apply where the tax loss component is an attributed CFC net loss or a FIF net loss (see s IQ 4).

19 Where the tax loss component is an attributed CFC net loss or a FIF net loss, the requirements in s IQ 4 must be met. This includes the requirement that the group of companies are in a wholly owned group of companies.

The shareholding of Z Co has remained unchanged since incorporation and is as follows:



The losses of Z Co arose before the date of amalgamation. Accordingly, Z Co can share its losses with A Co if Z Co meets a continuity test and the following commonality tests.

Commonality of shareholding between B Co (amalgamating company) and Z Co is at least 66% from the start of the income year in which the loss arose (1 April 2021) to the date of amalgamation (31 March 2023)

Shareholder	B Co	Z Co	Commonality of voting interest
C	20%	30%	20%
D	45%	50%	45%
E	35%	20%	20%
			85%

Commonality of shareholding between A Co (amalgamated company) and Z Co is at least 66% from the start of the income year in which the loss arose (1 April 2021) to the date of amalgamation (31 March 2023)

Shareholder	A Co	Z Co	Commonality of voting interest
C	10%	30%	10%
D	50%	50%	50%
E	40%	20%	20%
			80%

Commonality of shareholding between A Co (amalgamated company) and Z Co is at least 66% after amalgamation (1 April 2023) until the date of offset (31 March 2024)

Shareholder	A Co	Z Co	Commonality of voting interest
C	19%	30%	19%
D	45.5%	50%	45.5%
E	35.5%	20%	20%
			84.5%

As A Co, B Co and Z Co were at least 66% commonly owned from the start of the income year in which the losses arose until the date of offset, Z Co can offset its losses against A Co's net income in the 2024 income year.

Ordering of tax losses

80. Tax loss components included in a tax loss must be used in the order that they arose (s IA 9(1)).

81. An amalgamated company may have tax loss components for the same tax year. Where this occurs, the amalgamated company can notify the Commissioner of the order in which the losses are to be used. If no notification is made the losses must be used on a pro rata basis (s IA 9(3)).[20]

82. Example | Tauira 16 illustrates how the ordering rules apply when an amalgamated company has tax loss components for the same tax year.

Example | Tauira 16 – Using tax losses that arose in the same income year

A Co amalgamates with B Co, C Co and D Co on 31 March 2023. A Co is the amalgamated company.

A Co has net income in its 2024 income year of $30,000.

A Co, C Co and D Co incurred losses in prior years as follows:

A Co: $10,000; 2021 income year

C Co: $30,000; 2022 income year

D Co: $20,000; 2022 income year

A Co files its 2024 income tax return without making any notification to the Commissioner about the order in which it will use its 2022 tax losses.

C Co's 2022 tax loss ($30,000) is 60% of the total 2022 tax loss ($50,000) (30,000/50,000 = 60%) and D's tax loss is 40% of the total 2022 tax losses. It follows that A Co's losses will be used in this way:

Net income	$30,000
Losses from 2021 income year (A Co)	($10,000)
Losses from 2022 income year (C Co)	($12,000) (60% of the remaining net income of A Co following the offset of its 2021 tax loss ($20,000))
Losses from 2022 income year (D Co)	($8,000) (40% of the remaining net income of A Co following the offset of its 2021 tax loss ($20,000))

The losses A Co carries forward to the 2025 income year are as follows:

C Co: $18,000; 2022 income year

D Co: $12,000; 2022 income year

Alternatively, A Co may make an election when filing its 2024 income tax return to use all of D Co's 2022 tax loss ($20,000) or $20,000 of C Co's 2022 tax loss of $30,000.

20 See IR 432 Declaration of an amalgamation (July 2024) discusses the making of this election.

Appendix: Loss concepts

A1. This appendix summarises loss concepts that this statement refers to.

Tax loss

A2. A tax loss is essentially the total loss amount for the tax year that a loss company can share or carry forward to the subsequent tax year.

A3. A loss company's "tax loss" for a tax year comprises:

- the loss balance carried forward to the tax year;
- as relevant:
  - less the loss company's net income for the tax year; or
  - plus the loss company's net loss for the tax year;[21] and
  - plus various other amounts listed in s IA 2(4), for example, an amount of converted imputation credits arising under s LE 2 and an unused attributed controlled foreign company (CFC) or foreign investment fund (FIF) net loss for the tax year under ss IQ 2(3) and IQ 3(3).

A4. A loss balance carried forward to a tax year is usually the loss for the preceding tax year that was not used in that year.[22]

A5. For further information on "tax loss", see [33] to [36] of IS 22/07.

Tax loss component

A6. A tax loss is made up of tax loss components. The concept of a tax loss component is important because the continuity and commonality requirements (discussed further from [A8] (continuity) and [A11] (commonality)) must be tested for each component. Generally, tax loss components included in a tax loss must be used in the order in which they arose.

A7. Tax loss components include:

- net losses from previous tax years (included in the loss balance carried forward to the tax year);
- the loss company's net loss for the tax year (if any);
- certain additional amounts listed in s IA 2(4), for example, an amount of converted imputation credits arising under s LE 2 and an unused attributed CFC or FIF net loss for the tax year under ss IQ 2(3) and IQ 3(3); and
- certain losses arising before the 2009 income year that the loss company was entitled to carry forward under previous legislation.

Continuity tests

A8. If a company is to carry forward a tax loss, one of the following continuity tests must met:

- at least 49% continuity in the ownership of the loss company (**ownership continuity**); and/or
- continuity of the business activities of the loss company (**business continuity**).[23]

A9. Continuity must be tested for each tax loss component and must be maintained for the continuity period applying to that component. Broadly, the continuity period is the period from the start of the income year in which the tax loss component arose to the end of the income year in which the loss is used.[24]

A10. For further information on the continuity tests, see [48] to [59] of IS 22/07. For guidance on the main aspects of the business continuity test, see **IS 22/06**: **Loss carry-forward – continuity of business activities**.

21 A person's "net loss" for a tax year is the difference between the person's annual total deductions and their annual gross income (ie, where the annual total deductions exceed the annual gross income).

22 Section IA 3(4). The main way that a company can use a tax loss is by sharing it with a group company (s IA 3(2)). It can also use a tax loss to pay shortfall penalties (s IA 3(1)) or to reduce the amount of a taxable distribution received from a non-complying trust (s IA 3(3)).

23 The business continuity test may enable a company to carry forward tax losses despite a breach in ownership continuity if certain requirements are satisfied.

24 Subject to application of the part-year rules.

Ownership commonality

A11. To share a tax loss with another company, the companies must satisfy the commonality requirement.

A12. Commonality refers to the requirement for companies to be at least 66% commonly owned. That is, there is a group of persons who hold in each company:

- common voting interests that add up to at least 66%; and
- if a market value circumstance exists for a company, common market value interests that add up to at least 66%.

A13. Companies that meet the commonality requirement are referred to in the loss rules as a "group of companies".

A14. Commonality must be tested for each tax loss component and be satisfied for the commonality period applying to that tax loss component. Broadly, the commonality period is the period from the start of the loss company's income year in which the tax loss component arose to the end of the income year in which the loss is used.

A15. The requirement for the commonality to be met at all times during the commonality period means that it is important to consider where a company was incorporated or when it became a member of the group of companies.

A16. For further information on "commonality", see [78] to [92] of IS 22/07.

Part-year rules

A17. The general loss rules include what they refer to as the "part-year rules".

A18. The part-year rules recognise that part way through an income year, an event (eg, a change in the shareholding of a loss company) could result in companies either breaching or establishing continuity or ownership commonality for a tax loss component or a group of persons.

A19. In the absence of the part-year rules, if a continuity or commonality event occurred part way through the income year, this could prevent a company from using a tax loss component for the income year, or from carrying it forward.

A20. The part-year rules ensure that, in these cases, companies can still use certain losses in the relevant part-year periods. This is consistent with the purpose of the loss rules (to ensure that, largely, losses are available for the person who ultimately incurred the losses to use). It also avoids an outcome that would otherwise follow from the assessment of income tax on an annualised basis.

A21. For further information on how the part-year rules apply, see [197] to [242] of IS 22/07.

A22. Other part-year rules cater for breaches of the business continuity rules. However, these rules are outside the scope of this interpretation statement. For more information on these rules, see IS 22/06.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Income Tax Act 2007, ss IA 2, IA 3, IA 4, IA 9, IC 2, IC 5, IC 6, IC 7, IC 8, IC 9, IE 1 to IE 5, IQ 2, IQ 3, IQ 4, LE 2, YC 10 and subpart BC

Other references | Tohutoro anō

IS 22/06: Loss carry-forward – continuity of business activities *Tax Information Bulletin* Vol 34, No 11 (December 2022): 23
taxtechnical.ird.govt.nz/tib/volume-34---2022/tib-vol-34-no11
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IS 22/07: Company losses – ownership continuity, sharing and measurement *Tax Information Bulletin* Vol 34, No 11 (December 2022): 53
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taxtechnical.ird.govt.nz/interpretation-statements/2022/is-22-07

IS 25/10: Income tax and GST – Amalgamations (April 2025)
taxtechnical.ird.govt.nz/interpretation-statements/2025/is-25-10

Declaration of an amalgamation – IR 432 (form, Inland Revenue, July 2024)
ird.govt.nz/-/media/project/ir/home/documents/forms-and-guides/ir400---ir499/ir432/ir432-2011.pdf?modified=20200507233826&modified=20200507233826 (PDF 164KB)

IS 25/10: Income tax and GST – Amalgamations

Issued | Tukuna: 4 April 2025

This interpretation statement provides guidance on the tax treatment of company amalgamations.

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

Key terms | Kīanga tau tāpua

Amalgamation	An amalgamation that occurs under Part 13 or 15 of the Companies Act 1993 (or under a foreign law that has the same or similar effect to Part 13 or 15) that causes two or more companies to amalgamate and continue as one company. Includes certain transfers between building societies under s 33 of the Building Societies Act 1965.
Amalgamating company	A company that amalgamates with one or more other companies under an amalgamation. Generally, it includes both the continuing company and any company that ceases to exist after the amalgamation. However, in this statement, unless otherwise specified, **amalgamating company** means only the company that ceases to exist after an amalgamation.
Amalgamated company	The company that continues or survives after an amalgamation or a new company (ie, the continuing company).
Concessionary amalgamation	An amalgamation that is a "resident's restricted amalgamation" (as defined in s FO 3 the Act) and receives concessionary tax treatment under subpart FO.
Non-concessionary amalgamation	An amalgamation either that does not meet the criteria for a concessionary amalgamation or that the companies elect not to treat as a concessionary amalgamation.

Summary | Whakarāpopoto

1. This interpretation statement provides guidance on the income tax and GST treatment of amalgamations. It does not address the tax treatment of losses on amalgamation or how an amalgamated company calculates its available subscribed capital. The following items consider those matters:
   - **IS 25/09: Tax treatment of losses on amalgamation**; and
   - **QB 25/06: How does an amalgamated company calculate its available subscribed capital following an amalgamation?**
2. The amalgamation rules provide the income tax consequences when companies amalgamate. Subpart FO contains most of the amalgamation rules.
3. The amalgamation rules generally provide tax concessions when an amalgamation is a concessionary amalgamation. The amalgamation rules may also apply to amalgamations that do not fit the criteria for a concessionary amalgamation (non-concessionary amalgamation).
4. This statement will indicate where tax treatment differs between concessionary amalgamations and non-concessionary amalgamations.
5. Table | Tūtohi 1 summarises the provisions in subpart FO for amalgamations. It also identifies the starting paragraph where each provision is discussed in more detail in this statement.

6. Other provisions also apply to amalgamations. This statement considers those provisions under the heading “Other matters” (including matters such as dividends, provisional tax and imputation credit accounts) from [97], FBT from [124], GST from [130] and administrative matters from [143].

Table | Tūtohi 1 - Summary of amalgamations provisions in subpart FO

Section	Subject covered	Comment	Application
FO 4	Rights and obligations of amalgamated companies (see from [20])	Amalgamated company assumes rights, obligations and liabilities of amalgamating companies	All amalgamations
FO 5	Remitted liabilities (see from [26])	No income arises to an amalgamating company merely because the amalgamated company succeeds to the unpaid liabilities of an amalgamating company	All amalgamations
FO 6	Cancellation of shares (see from [30])	Amalgamating company disposes of shares in another amalgamating company at cost	All amalgamations
FO 7	Income derived after amalgamation (see from [36])	Income of amalgamated company	All amalgamations
FO 8	Bad debts and expenditure or loss (see from [38])	Amalgamated company entitled to deductions for pre-amalgamation activities	Concessionary amalgamation
FO 9	Unexpired portion of prepaid expenditure (see from [42])	Allocate up to amalgamation date	All amalgamations
FO 10	Property passing (see from [44])	Default rule – amalgamated company steps into shoes of amalgamating company and inherits historical cost Broadly, the rule applies to depreciable property and revenue account property of both amalgamating and amalgamated companies Trading stock of both companies – disposal on amalgamation at tax book value Revenue account property of amalgamating company but capital property of amalgamated company – disposal on amalgamation at market value Financial arrangements –special rules	Concessionary amalgamation
FO 11	Property passing (see from [60])	Disposal on amalgamation at market value Limit on depreciation cost base if associated persons	Non-concessionary amalgamation

Section	Subject covered	Comment	Application
FO 12–14	Transfer of third-party financial arrangements	Default rule: No base price adjustment (BPA) – amalgamated company steps into the shoes of the amalgamating company (s FO 12; see from [70]) Does not meet default rule and does not change spreading method: BPA on disposal – but fair and reasonable allocation (s FO 13; see from [75]) Does not meet default rule and changes spreading method: BPA on disposal at market value (s FO 14; see from [80])	Concessionary amalgamation
FO 15	Transfer of financial arrangements (see from [82]	Market price for assuming obligation under financial arrangement	Non-concessionary amalgamation
FO 16	Amortising property (see from [48])	Amalgamated company steps into shoes of amalgamating company – supplements s FO 10	Concessionary amalgamation
FO 17	Land (see from [53])	Different rules apply to land that is: • held on capital account; • held on revenue account; or • subject to bright-line or 10-year rule	Concessionary amalgamation
FO 18	Financial arrangements between amalgamating companies (see from [84])	Disposal at face value if borrower able to repay financial arrangement Disposal at market value if borrower unable to repay financial arrangement	Concessionary amalgamation

Company amalgamations – general overview

7. Broadly, the Companies Act 1993 (CA 1993) allows two or more companies to amalgamate and continue as one company. That company may be one of the amalgamating companies or a new company.
8. The CA 1993 provides that an amalgamated company succeeds to all the property, rights, powers and privileges of each amalgamating company. It also assumes all of their liabilities and obligations.
9. Amalgamations may be either long form or short form under part 13 of the CA 1993:
   - The long-form amalgamation procedure is in ss 220 and 221 of the CA 1993. A long-form amalgamation is commonly used when companies are unrelated.
   - The short-form amalgamation procedure is in s 222 of the CA 1993.
10. Amalgamations may also occur under part 15 of the CA 1993 for court-approved amalgamations and amalgamations involving a code company (broadly, certain companies that have financial products).

Income tax consequences of an amalgamation – general concepts

11. Subpart FO sets out the income tax consequences for when companies amalgamate. Most amalgamations that are subject to subpart FO will be amalgamations that occur under part 13 of the CA 1993. Section 225(a) of the CA 1993 provides that the amalgamation is effective on the date shown in a certificate of amalgamation.

12. However, "amalgamation" in s YA 1 also includes:
    - amalgamations that occur under a foreign law that has an effect that is the same as or similar to part 13 or part 15 of the CA 1993 and causes two or more companies to amalgamate and continue as one company; and
    - a transfer by a building society of all of its engagements to another building society under s 33 of the Building Societies Act 1965 if certain requirements are met.

Concessionary amalgamation

13. Generally, subpart FO provides tax concessions when a concessionary amalgamation occurs (s FO 1).
14. The broad principles of a concessionary amalgamation are:
    - the amalgamated company acquires most assets of the amalgamating companies at their tax book value;
    - the amalgamated company inherits the tax losses and imputation credits of the amalgamating companies if continuity and commonality tests are met; and
    - the amalgamating companies do not derive income or incur a loss.
15. To be a concessionary amalgamation, each of the amalgamating companies and the amalgamated company must, at the time of the amalgamation:
    - be New Zealand resident; and
    - not:
        - be treated as resident in another country under a double tax agreement; or
        - derive only exempt income (unless the exempt income is dividends from a foreign company (s CW 9) or dividends between wholly-owned group members (s CW 10)).
16. If the amalgamated company is a qualifying company (a regime which is being phased out) immediately after the amalgamation, each of the amalgamating companies must also be a qualifying company at the time of the amalgamation. However, a qualifying company can amalgamate into an amalgamated company that is not a qualifying company.[1]
17. Section HF 3(2)(a) provides that a Māori authority must not amalgamate with a company that is not a Māori authority.
18. Companies can choose not to treat the amalgamation as a concessionary amalgamation by notifying the Commissioner under s 75 of the Tax Administration Act 1994 (TAA). For example, the companies may want the assets of the amalgamating companies to transfer to the amalgamated company at market value. Section 75 of the TAA is discussed further at [143].
19. The provisions in subpart FO may apply to all amalgamations, to concessionary amalgamations only or to non-concessionary amalgamations only (depending on the context).

Rights and obligations of amalgamated companies

20. Several amalgamation provisions in the Act refer to an amalgamating company "ending its existence" on amalgamation. This wording refers to an amalgamating company ceasing to exist as a separate entity, because it is removed from the register of companies under the CA 1993.
21. However, the rights and obligations of the amalgamating company continue to exist in the form of the amalgamated company for income tax purposes. For example, an amalgamated company could rely on a ruling previously issued to an amalgamating company.[2]
22. When an amalgamating company ceases to exist on amalgamation, for the income year of the amalgamation and all earlier income years (s FO 4) the amalgamated company:
    - must comply with the obligations of the amalgamating company under the Inland Revenue Acts;
    - must meet the liabilities of the amalgamating company under the Inland Revenue Acts; and
    - is entitled to the rights, powers and privileges of the amalgamating company under the Inland Revenue Acts.

1 See s HA 23 for the treatment of tax losses on amalgamation where a company that is not a qualifying company amalgamates with a qualifying company and ends its existence on the amalgamation.

2 See IS0081: **The impact of company amalgamations on binding rulings**.

23. These obligations and entitlements are mirrored in s 76 of the TAA. Section 76 is discussed from [145].
24. An amalgamated company notifies the Commissioner of an amalgamation by filing a **Declaration of an amalgamation – IR 432**.
25. The amalgamation rules set out in the following sections explain the specific tax consequences when companies amalgamate.

Remitted liabilities (s FO 5)

26. On amalgamation, the amalgamated company assumes all the liabilities and obligations of each amalgamating company.
27. No income arises merely because the amalgamated company assumes the liabilities of an amalgamating company (s FO 5). This is because the amalgamated company will be responsible for paying the liabilities. Different rules apply where the liability is a financial arrangement (discussed at [67]).
28. Section FO 5 also modifies the effect of s CG 2C (remitted amounts). Section CG 2C provides that income arises to a profit company if:
    - the profit company has received the benefit of a loss from a loss company;
    - the loss company's liability for the loss is remitted or cancelled; and
    - the loss company is removed from the register of companies.
29. If an amalgamating company incurred deductible expenditure that it was liable to pay and that was offset as losses to another group company, the amalgamated company is treated as if it were the amalgamating company from the amalgamation date until the liabilities are met. This treatment prevents group companies from avoiding the effect of s CG 2C by amalgamating the two companies and liquidating the amalgamated company.[3]

Cancellation of shares (s FO 6)

30. Part 13 of the CA 1993 provides when shares of an amalgamating company must be cancelled without payment or other consideration.[4]
31. Any shares an amalgamating company or amalgamated company (A Co) holds in another amalgamating company (B Co) that are cancelled on amalgamation are deemed to be disposed of at cost immediately before the amalgamation (s FO 6). This means no taxable gain or loss arises for A Co from the cancellation of B Co's shares.
32. Example | Tauira 1 illustrates a situation where shares an amalgamated company holds in an amalgamating company are cancelled on amalgamation.

Example | Tauira 1 – Cancellation of shares at cost

B Co has issued 100 shares at $1 per share. A Co holds 20 of B Co's shares on capital account.

A Co and B Co amalgamate. A Co continues as the amalgamated company.

Under the amalgamation the shares in B Co that A Co holds, are cancelled without payment or other consideration.

- A Co is deemed to dispose of its 20 shares in B Co for $20 (the cost of the shares).
- A Co has no gain or loss on disposal of the shares.

33. The outcome in Example | Tauira 1 would be the same if A Co held the B Co shares on revenue account. Section FO 6, because it is a specific provision for amalgamations, overrides any general market value disposal rules, such as s GC 1 (disposals of trading stock at below market value).
34. All shares in an amalgamating company that ceases to exist on amalgamation also cease to exist. As discussed at [31], s FO 6 applies to shares in an amalgamating company held by another amalgamating company or the amalgamated company. No specific rule in the amalgamation rules discusses the tax treatment where other shareholders hold shares in an amalgamating company. In that situation the tax treatment will be determined based on the general provisions of the Act.

3 Section FO 5(2).

4 Sections 220(3), 222(1)(b)(i) and 222(2)(b)(i) of the CA 1993.

35. The CA 1993 provides some flexibility as to how amalgamations occur. For example, shares in the amalgamating company that are not required to be cancelled might convert to shares in the amalgamated company, or they might be cancelled (and new shares issued), or the shareholder might exit for cash. How the general provisions of the Act apply will depend on the particular facts.

Income derived after amalgamation (s FO 7)

36. If an amalgamated company derives an amount after the amalgamation because of the actions of an amalgamating company, the amount is income of the amalgamated company where it would have been income of the amalgamating company but for the amalgamation (s FO 7). The amount is income of the amalgamated company in the income year that it is derived.[5]

37. Example | Tauira 2 illustrates a situation where an amalgamated company derives income as a result of an amalgamating company's pre-amalgamation actions.

Example | Tauira 2 – Income derived as a result of an amalgamating company's actions before amalgamation

B Co (a furniture-making business) has partially manufactured furniture for a client when it amalgamates with A Co. A Co continues as the amalgamated company. When A Co invoices the client for the furniture after it is completed, the amount derived is income of A Co.

Bad debts and expenditure or loss (s FO 8)

38. An amalgamated company is entitled to a deduction for any debts acquired from an amalgamating company that it writes off as bad or for any expenditure or loss that it incurs as a result of the activities of an amalgamating company before the amalgamation (s FO 8) if all of the following requirements are met:

- The amalgamation is a concessionary amalgamation.
- A deduction would have been available to the amalgamating company if it had continued to exist.
- A deduction is not otherwise available to the amalgamated company.

39. Example | Tauira 3 illustrates an amalgamated company that can claim a deduction for the debt of an amalgamating company that the amalgamated company writes off after amalgamation.

Example | Tauira 3 – Amalgamated company writes off amalgamating company's debt after amalgamation

B Co from Example | Tauira 2 invoiced a customer for furniture it sold before the amalgamation. The invoice was unpaid at the date of amalgamation.

Following the amalgamation, A Co writes the debt off as a bad debt.[6]

A Co can claim a deduction for the amount of the bad debt it wrote off.

40. Example | Tauira 4 illustrates a situation where an amalgamated company incurs deductible expenditure as a result of an amalgamating company's pre-amalgamation activities.

Example | Tauira 4 – Expenditure an amalgamated company incurs from an amalgamating company's activities before amalgamation

B Co from Example | Tauira 2 and Example | Tauira 3 ordered materials for making furniture before the amalgamation. B Co had not received delivery of the materials or received an invoice for the materials at the date of amalgamation.

The manufacturer invoices A Co on delivery of the materials. A Co can claim a deduction for the expenditure it incurred on the materials.

5 Section CV 4.

6 For guidance on when a debt is bad and which actions are sufficient to write off a debt as bad, see BR PUB 18/07: **Income Tax and Goods and Services Tax – Writing off debts as bad**.

41. Section FO 8 applies only where the amalgamation is a concessionary amalgamation. If an amalgamation is not a concessionary amalgamation, the ordinary tax rules will apply:
    - Acquired debts may be capital (non-deductible) or revenue (deductible) in nature, depending on the circumstances.
    - Whether it is possible to deduct other expenditure an amalgamated company incurs for an amalgamating company's pre-amalgamation activities depends on the circumstances.

Unexpired portion of prepaid expenditure (s FO 9)

42. An amalgamating company must include as income any unexpired portion of prepaid expenditure in its final tax return prepared for the company to the date of amalgamation. The unexpired portion of the amalgamating company's expenditure for the income year of amalgamation is treated as the amalgamated company's unexpired amount of the expenditure (s FO 9).[7] The outcome of this treatment is that the amalgamated company can deduct the unexpired portion of the expenditure (as at the amalgamation date) in the year of amalgamation and must add back as income any unexpired portion of the expenditure at year end.
43. Example | Tauira 5 illustrates how s FO 9 applies where an amalgamating company has an unexpired portion of prepaid expenditure at the date of amalgamation.

Example | Tauira 5 – Prepaid expenditure of an amalgamating company

B Co advertises in a furniture magazine. On 1 April 2023, B Co prepays $60,000 for its advertising for the 2024 income year ($5,000 per month).

B Co and A Co (both of which have a standard 31 March balance date) amalgamate on 31 December 2023. A Co continues as the amalgamated company.

B Co must include the unexpired portion of the expenditure as income in its final tax return for the period 1 April 2023 to 31 December 2023 (which consists of the amounts prepaid for January, February and March 2024, ie, 3 × $5,000 = $15,000). B Co has a net deduction of $45,000.

A Co can claim a deduction for the $15,000 in its tax return for the period 1 April 2023 to 31 March 2024 (ie, the total of the amounts prepaid for January, February and March 2024).

Property passing on amalgamation (s FO 10)

Concessionary amalgamation – general rule for property passing

44. The general rule for property (excluding financial arrangements) that passes on a concessionary amalgamation is as follows:
    - The passing of ownership of the property on amalgamation is treated as a disposal of the property by the amalgamating company and an acquisition by the amalgamated company (s FO 10(3)).
    - The amalgamating company is deemed to have disposed of its property to the amalgamated company immediately before the amalgamation (s FO 10(3)).
    - The amalgamated company is treated as having acquired the property on the date the amalgamating company acquired the property for the sum of (s FO 10(4)):
        - the original purchase price; plus
        - any expenditure incurred in purchasing or improving the property; plus
        - any expenditure incurred in securing or improving the amalgamating company's legal rights to the property.
45. Broadly, the general rule has two effects:
    - The amalgamating company will not derive income or incur a loss from the disposal.
    - The cost base of the property is rolled over to the amalgamated company (ie, the amalgamated company 'steps into the shoes' of the amalgamating company).

7 Taxpayers should also consider whether Determination E12 – Persons excused from complying with section EA 3 of the Income Tax Act 2007 may apply.

46. The general rule will most often apply to depreciable property. Some modifications to the general rule apply to amortising property (which includes depreciable property) (discussed from [48]) and land (discussed from [53]).

47. Different rules apply to the disposal of property that is trading stock of both companies (discussed at [55]) and to the disposal of revenue account property (if the property is revenue account property of the amalgamating company but not revenue account property of the amalgamated company) (discussed from [56]).

Amortising property (s FO 16)

48. On a concessionary amalgamation, the following modified rules apply:
    - The amalgamating company will not derive any depreciation recovery income or incur a loss on disposal as a result of the deemed disposal (s FO 16(1B)).
    - The amalgamated company is deemed to have been allowed the depreciation or amortisation deductions taken by the amalgamating company (s FO 16(4)).
    - The amalgamating company is allowed a depreciation deduction for the property transferred to the amalgamated company for the period beginning on the first day of the income year of amalgamation and ending on the day before the date of amalgamation (s FO 10(7) and s DV 15(3)).
    - The amalgamated company is allowed a depreciation deduction for the property from the amalgamation date to the end of the relevant income year.

49. Example | Tauira 6 illustrates the tax outcome when depreciable property passes from an amalgamating company to an amalgamated company on a concessionary amalgamation.

Example | Tauira 6 – Passing of depreciable property on a concessionary amalgamation

A Co and B Co amalgamate on 1 April 2024. A Co continues as the amalgamated company. The amalgamation is a concessionary amalgamation.

Both companies have a 30 June balance date.

B Co owned the following depreciable assets before the amalgamation:

Asset	Cost	Date acquired	Dep rate (DV)	Closing tax book value at 30 June 2023	Depreciation deduction 2024		
					Full year	9/12 B Co	3/12 A Co
Motor vehicle	$25,000	1 July 2020	30%	$8,575	$2,572	$1,929	$643
Laptop	$2,800	31 March 2022	50%	$1,166	$583	$437	$146

On amalgamation, the tax outcome is as follows:

- A Co is deemed to have acquired the motor vehicle and laptop from B Co on the same date as B Co acquired them (1 July 2020 for the motor vehicle and 31 March 2022 for the laptop) and for the same cost ($25,000 for the motor vehicle and $2,800 for the laptop).
- B Co has no depreciation recovery income or depreciation loss on the deemed disposal on the motor vehicle and laptop.
- B Co can claim a depreciation deduction for the assets for the 9-month period beginning on 1 July 2023 (the beginning of its income year) and ending on 31 March 2024 (the day before the amalgamation) of $1,929 for the motor vehicle and $437 for the laptop.
- A Co can claim a depreciation deduction for the assets for the 3-month period from 1 April 2024 to 30 June 2024 of $643 for the motor vehicle and $146 for the laptop.

Pool property

50. Different rules apply to depreciable property that is subject to the pool method. Broadly, under the pool method, the following rules apply:
    - The taxpayer elects that a collection of low-value assets is treated as one asset and depreciated at the lowest diminishing value rate applicable to the assets in the pool.
    - When a pooled asset is disposed of, the sale proceeds are deducted from the adjusted tax value of the pool. If the sale proceeds:
        - are more than the adjusted tax value of the pool, the difference is income; or
        - are less than the adjusted tax value of the pool, the difference is deductible.
    - Once assets are pooled, they are no longer treated as individual assets, so any capital gain made on the sale of any or all assets from the pool cannot be separated from depreciation recovered. The entire proceeds of any sale of pooled assets must be accounted for and any gains are taxable income.
51. If the depreciable property passing on amalgamation:
    - forms the **whole** of the pool property of the amalgamating company, no income or loss arises to the amalgamating company, because the disposal is deemed to occur at the pool's adjusted tax value; or
    - forms **part** of the pool property of the amalgamating company, no income or loss arises to the amalgamating company, because the disposal is deemed to occur at either market value or the adjusted tax value of the pool, whichever is lower.
52. Example | Tauira 7 illustrates a situation where depreciable property that is subject to the pool method passes from an amalgamating company to an amalgamated company on a concessionary amalgamation.

Example | Tauira 7 – Passing of pool property on a concessionary amalgamation

A Co and B Co amalgamate on 1 January 2024. A Co continues as the amalgamated company. The amalgamation is a concessionary amalgamation.

Both companies have a 31 March balance date.

B Co pooled its depreciable property. The adjusted tax value of the pool was $500,000 on 31 December 2023. The entire pool passes to A Co on amalgamation.

B Co claims depreciation on the pool for the period 1 April 2023 to 31 December 2023. Also, B Co has no income or loss on the disposal of its pool property ($500,000 less $500,000).

The adjusted tax value of the pool property to A Co is $500,000. A Co claims depreciation on the pool for the period 1 January 2024 to 31 March 2024.

Land (ss FO 10 and FO 17)

53. In general, land passes from an amalgamating company to the amalgamated company on a concessionary amalgamation at cost or market value. Whether land passes at cost or market value depends on how the amalgamating company and amalgamated company hold the land.
54. Table | Tūtohi 2 summarises when land passes at cost and when it passes at market value. In this table, any reference to "bright-line or 10-year rule" means the 2-year bright-line test under s CB 6A, or the 10-year rule for land under any of ss CB 9 to CB 11 and s CB 14.

Table | Tūtohi 2 - Passing of land on a concessionary amalgamation

Amalgamating company (B Co)	Amalgamated company (A Co)	Outcome	Section
Land held on capital account	Land held on capital account	A Co inherits B Co's cost and acquisition date No income or loss arises to B Co	FO 10(4)
Land held on capital account	Land held on revenue account	B Co disposes of land on amalgamation at market value A Co acquires land on amalgamation at market value	FO 17(2)(a)
Land held on revenue account (excluding bright-line or 10-year rule)	Land held on capital account	B Co disposes of land on amalgamation at market value A Co acquires land on amalgamation at market value	FO 10(6)
Land held on revenue account (excluding bright-line or 10-year rule)	Land held on revenue account (excluding bright-line or 10-year rule)	A Co inherits B Co's cost and acquisition date No income or loss arises to B Co	FO 10(4)
Land held on revenue account (excluding bright-line or 10-year rule)	Bright-line or 10year rule may apply from amalgamation date	B Co disposes of land on amalgamation at market value A Co acquires land on amalgamation at market value	FO 17(2)(b)
Land held on revenue account because of bright-line or 10-year rule	Bright-line or 10year rule may apply from date when B Co acquired land	A Co inherits B Co's cost and acquisition date No income or loss arises to B Co A Co taxable on any gain if sells within bright-line or 10-year rule from date B Co acquired land	FO 10(4) FO 17(3)

Trading stock

55. If the property is trading stock for both the amalgamating company and the amalgamated company, the consideration for the disposal and acquisition is the value of the trading stock to the amalgamating company determined under subpart EB at the time of amalgamation. This means no gain or loss should arise on the deemed disposal of the trading stock.

Revenue account property

56. Broadly, property is revenue account property if it is trading stock or property where a taxable gain or deductible loss arises when sold. Conversely, property is capital account property if the sale of the property results in a non-taxable, non-deductible capital gain or loss.

57. Property that is revenue account property of the amalgamating company, but capital account property of the amalgamated company is treated as disposed of and acquired at the property's market value at the time of the amalgamation under s FO 10(6).

58. Section FO 10(6) does not apply to land that is revenue account property of the amalgamating company merely because of the bright-line test or the 10-year rule in the land provisions.

59. Section FO 10(6) ensures that any unrealised gains are income when an asset moves out of the tax base on amalgamation (ie, it moves from being held on revenue to capital account).

Non-concessionary amalgamation – property passing (s FO 11)

60. Under a non-concessionary amalgamation, property of an amalgamating company is deemed to pass to the amalgamated company on amalgamation at market value (s FO 11(1)). This means the amalgamating company may derive income or incur a loss. "Property" is something capable of being owned and transferred and includes, for example, trading stock, revenue account property, land and fixed assets.

61. Section EE 41 modifies this rule for depreciable property where the amalgamating company and amalgamated company are associated persons at the time of amalgamation. Broadly, s EE 41 prevents associated companies from using the amalgamation rules to increase depreciation deductions by transferring depreciable assets that have a market value greater than cost.

62. Most often, the cost of the property for the amalgamated company for depreciation purposes is the lesser of the following two amounts under s EE 41:
    - the market value of the property at the time the amalgamated company acquired it; and
    - the cost of the item to the amalgamating company.

63. Different rules apply where the depreciable property was not always used for the purpose of deriving assessable income and was later brought into the tax base.[8]

64. Despite s EE 41, the cost of the item to the amalgamated company may be used if:
    - the property is not depreciable intangible property (eg, software) and the Commissioner approves the cost; or
    - the amalgamating company derives income from the transfer of the property to the amalgamated company (other than as depreciation recovery income).

65. The amalgamated company cannot depreciate the property at a higher depreciation rate than the rate that the amalgamating company used.[9]

66. Example | Tauira 8 illustrates how s FO 11 applies to the passing of depreciable property between associated persons on a non-concessionary amalgamation.

Example | Tauira 8 – Passing of depreciable property between associated persons on a non-concessionary amalgamation

B Co and A Co are wholly owned. B Co amalgamates with A Co. A Co continues as the amalgamated company.

B Co owned plant that cost $500,000 and had a tax book value of $250,000 and a market value of $700,000. B Co depreciated the plant at a 10% straight-line rate.

The companies elect for a non-concessionary amalgamation.

A Co must depreciate the plant using a cost of $500,000 under s EE 41. B Co is treated as disposing of the plant to A Co for its market value on the date of amalgamation under s FO 11 resulting in depreciation recovery income of $250,000.

The current depreciation rate for the plant is 12% straight line. If A Co wishes to use the straight-line rate, it must use a depreciation rate of 10% straight line (as it cannot exceed B Co's depreciation rate of 10%).

If A Co wishes to use the diminishing value rate it must be no more than the diminishing value equivalent of the straight-line rate used by B Co (10%). The equivalent diminishing value rate of the straight-line rate of 10% is 15% (see Schedule 10 of the Act).

8 See EE 41(2)(a).

9 See s EE 41(4). Where the amalgamated company uses a different depreciation method from the amalgamating company, the rate applied cannot be more than a rate equivalent to the rate that the amalgamating company used. Schedule 10 sets out the straight-line equivalents of diminishing value rates of depreciation.

Financial arrangements

67. The financial arrangements rules (FA rules) govern the tax treatment of financial arrangements, such as a loan. Broadly, the FA rules:
    - require parties to a financial arrangement to spread income or expenditure from the arrangement over its term;
    - override the capital limitation; and
    - aim to stop the acceleration of deductions for expenditure and the deferral of income recognition.
68. A base price adjustment (BPA) is required when a financial arrangement matures to calculate the final income or expenditure arising from the financial arrangement (ie, a "wash-up" calculation). Generally, a BPA is also required when a financial arrangement is transferred to allocate income and expenditure in the year of transfer between the transferor and the transferee (unless an exception applies).
69. Different rules apply depending on whether the financial arrangement is with a third party or between companies that are involved in the amalgamation.

Concessionary amalgamation – transfer of third-party financial arrangements (ss FO 12, 13 and 14)

Transfer of third-party financial arrangements – default rule (s FO 12)

70. On a concessionary amalgamation, the amalgamated company can step into the shoes of the amalgamating company in relation to a financial arrangement that passes to it (s FO 12). This means there is no BPA on amalgamation, if all of the following requirements are met:
    - The FA rules apply to the financial arrangement.
    - For the whole of the income year before the amalgamation, the amalgamating company and amalgamated company were part of the same wholly owned group.
    - The amalgamated company uses the same method of calculating income and expenditure for the financial arrangement (spreading method) as the amalgamating company used. For example, both use the yield to maturity method.
    - The amalgamating company does not have losses carried forward from an earlier year or years that could not be attributed to the amalgamated company.[10]
71. If these conditions are met and the amalgamated company makes an election, the following outcomes apply:
    - The amalgamating company is treated as if it had never held the financial arrangement before the amalgamation. The amalgamated company is treated as if it had acquired the financial arrangement on the same date and for the same consideration as the amalgamating company.
    - The amalgamated company is deemed to have incurred all other expenditure and to have derived all gains that the amalgamating company has incurred or derived before the amalgamation. Further, it is deemed to have included these amounts of income and expenditure in its income tax returns.
72. The amalgamated company makes the election by including in its tax return in the year of amalgamation any income or expenditure the amalgamating company derived or incurred under the financial arrangement in the year of the amalgamation (s FO 12(2)).
73. Section FO 12 applies regardless of:
    - s EW 42, which deems the acquisition of entitlements under a financial arrangement for no or inadequate consideration to be at market value; and
    - s GB 21, which deems arm's length consideration where parties to a financial arrangement deal with each other in a way that defeats the intention of the FA rules.

10 For a discussion of the treatment of tax losses of amalgamating companies, see IS 25/09: Tax treatment of losses on amalgamation.

74. Section FO 12 is the default rule. Example | Tauira 9 illustrates how it applies.

Example | Tauira 9 – Transfer of a bank deposit (default rule)

B Co and A Co are wholly owned companies. Both companies have a 31 March balance date.

On 1 April 2023, B Co deposited $100,000 with a bank at an interest rate of 5% pa.

B Co amalgamates with A Co on 31 December 2023. A Co continues as the amalgamated company. The amalgamation is a concessionary amalgamation.

B Co's final tax return for the period 1 April 2023 to 31 December 2023 excludes any interest earned on the bank deposit.

A Co's tax return for the 2024 income year (ending 31 March) includes interest income of $5,000 earned on the bank deposit.

Transfer of third-party financial arrangements – default rule not met but no change in spreading method (s FO 13)

75. Section FO 13 applies if the requirements for the s FO 12 default rule discussed from [70] are not met and there is no change in the spreading method after the amalgamation. For example, if the amalgamating company and amalgamated company were not in a wholly owned group of companies before the amalgamation.

76. Section FO 13 treats the amalgamating company as having disposed of the financial arrangement. The disposal triggers a BPA. The consideration for the disposal under s FO 13 is the amount that means the BPA gives a fair and reasonable allocation between the amalgamating company and amalgamated company in the year of amalgamation of the interest expenditure or income that the amalgamating company would have incurred or derived if the amalgamation had not taken place. This ensures that the FA rules give the correct amount of expenditure or income over the life of the financial arrangement.

77. The BPA formula is as follows (s EW 31(5)):

consideration – income + expenditure + amount remitted

78. Table | Tūtohi 3 defines each of the elements in this formula.

Table | Tūtohi 3: Elements in the BPA formula

BPA item	Definition
Consideration	Plus all consideration that has been paid or is or will be payable **to** the person (Less all consideration that has been paid or is or will be payable **by** the person under the financial arrangement)
(Income)	(Less amounts derived by the person under the financial arrangement in earlier income years)
Expenditure	Plus amounts incurred **by** the person under the financial arrangement in earlier income years
Amount remitted	Plus an amount not included in the consideration paid or payable to the person because it has been remitted by the person or by law

79. Example | Tauira 10 illustrates how the rule in s FO 13 applies.

Example | Tauira 10 – Bank deposit (default rule does not apply but no change in spreading method)

On 1 April 2023, B Co deposited $100,000 with its bank at an interest rate of 5% per annum (interest payable annually in arrears).

B Co amalgamates with A Co on 31 December 2023. A Co continues as the amalgamated company. The amalgamation is a concessionary amalgamation.

Both companies have a 31 March balance date.

B Co and A Co are **not** wholly owned but apply the same spreading method to the bank deposit.

As B Co has held the deposit for 9 months before the amalgamation, a fair and reasonable allocation of the interest income for the year would be $3,750 ($5,000 × 9/12 months). A Co's allocation would be $1,250 ($5,000 × 3/12 months).

To arrive at this outcome, the consideration paid **to** B Co (and by A Co) will need to be $103,750 as demonstrated by the BPA calculation below.

BPA item	Definition	Calculation for B Co
Consideration	Plus all consideration that has been paid or is or will be payable **to** the person (Less all consideration that has been paid or is or will be payable **by** the person under the financial arrangement)	$103,750 paid by A Co (balance figure) ($100,000) initial principal deposit paid to the bank
(Income)	(Less amounts derived by the person under the financial arrangement in earlier income years)	0
Expenditure	Plus amounts incurred by the person under the financial arrangement in earlier income years	0
Amount remitted	Plus an amount not included in the consideration paid or payable to the person because it has been remitted by the person or by law	0
BPA outcome		$3,750 income to B Co

BPA item	Definition	Calculation for A Co
Consideration	Plus all consideration that has been paid or is or will be payable **to** the person (Less all consideration that has been paid or is or will be payable **by** the person under the financial arrangement)	$105,000 principal repayment and interest from the bank ($103,750) paid to B Co (balance figure)
(Income)	(Less amounts derived by the person under the financial arrangement in earlier income years)	0
Expenditure	Plus amounts the person incurred under the financial arrangement in earlier income years	0
Amount remitted	Plus an amount not included in the consideration paid or payable to the person because it has been remitted by the person or by law	0
BPA outcome		$1,250 income to A Co

Transfer of third-party financial arrangements – default rule not met and there is a change in spreading method (s FO 14)

80. If neither s FO 12 nor s FO 13 applies (ie, there is a change in spreading method), the transfer of the financial arrangement is deemed to be at market value (s FO 14).

81. Example | Tauira 11 illustrates the outcome where the obligations of an amalgamating company under a financial arrangement pass to an amalgamated company at market value.

Example | Tauira 11 – Bank deposit in foreign currency (default rule not met and there is a change in spreading method)

B Co deposited US$100,000 to a bank on 1 April 2023, which converted to NZ$142,000 on that day. Interest is paid monthly in arrears at a floating interest rate.

B Co amalgamates with A Co on 31 December 2023. A Co continues as the amalgamated company. The amalgamation is a concessionary amalgamation.

Both companies have a 31 March balance date.

B Co and A Co apply different spreading methods to calculate income and expenditure under the US$ bank deposit.

On 31 December 2023, the US$100,000 deposit converted to NZ$166,000 (due to exchange rate fluctuations).

B Co is deemed to have disposed of the US$100,000 deposit to A Co on 31 December 2023 at NZ$166,000 under s FO 14.

In B Co's final tax return for the period 1 April 2023 to 31 December 2023, B Co has income (foreign exchange gain) under the BPA calculation of NZ$24,000 (NZ$166,000 consideration paid to B Co less NZ$142,000 consideration paid by B Co) plus interest income received.

A Co acquires the US$100,000 deposit for NZ$166,000.

Non-concessionary amalgamation – transfer of obligations under third-party financial arrangements (s FO 15)

82. On a non-concessionary amalgamation, where an obligation that an amalgamating company has under a financial arrangement passes to the amalgamated company:
    - the consideration for the disposal of a financial arrangement obligation by the amalgamating company is the market price for assuming the obligation at the time of amalgamation; and
    - the amalgamated company acquires the financial arrangement for the same amount and is treated as assuming the financial arrangement obligation.

83. Example | Tauira 12 illustrates the outcome where the obligations of an amalgamating company under a financial arrangement pass to an amalgamated company on a non-concessionary amalgamation.

Example | Tauira 12 – Transfer of financial arrangement obligation on a non-concessionary amalgamation

B Co borrowed US$100,000 from a bank on 1 April 2023, which converted to NZ$142,000 on that day. Interest is paid monthly in arrears at a floating interest rate.

B Co amalgamates with A Co on 31 December 2023. A Co continues as the amalgamated company. The amalgamation is a non-concessionary amalgamation.

A Co and B Co have a standard 31 March balance date.

On 31 December 2023, the US$100,000 loan converted to NZ$166,000 (due to exchange rate fluctuations).

The US$100,000 obligation is deemed to be transferred at NZ$166,000 under s FO 15.

In its final tax return for the period 1 April 2023 to 31 December 2023, B Co has a foreign exchange loss of NZ$24,000 (NZ$142,000 less NZ$166,000) plus interest expense incurred in the period.

A Co acquires the obligation to repay the US$100,000 loan for NZ$166,000.

Financial arrangements between amalgamating companies (s FO 18)

84. Where a financial arrangement is between companies involved in the amalgamation, the financial arrangement collapses on amalgamation (ie, the obligations and/or entitlements each party has under the financial arrangement merge).

85. Section FO 18 applies if s FO 21 does not apply. The following discussion on s FO 18 through to [91] assumes that s FO 21 does not apply. We discuss situations in which s FO 21 applies from [92].

86. In applying s FO 18, companies need to consider whether:
    - the borrower is able to meet its obligations under the financial arrangement at the time of the amalgamation; and
    - the amalgamation is a concessionary amalgamation.

Concessionary amalgamation – borrower can meet obligations

87. Under a concessionary amalgamation, if the borrower is solvent, or insolvent but likely to meet its obligations under the financial arrangement (eg, because property of the borrower fully secures the debt), the financial arrangement is deemed to be discharged immediately before the amalgamation for the accrued balance of the financial arrangement (s FO 18(2)(a)(i) and (ii)). In general, this means no income under the FA rules (referred to in this interpretation statement as "debt remission income") should arise to the borrower for unpaid amounts.

88. For example, for a loan, the accrued balance is the principal and unpaid interest accrued to the date of amalgamation. If any unpaid interest has accrued to the date of amalgamation, the deemed payment of this balance on discharge of the financial arrangement will give rise to income in the hands of the lender (and a corresponding deduction will arise in the hands of the borrower).

Concessionary amalgamation – borrower unlikely to meet its obligations under the financial arrangement

89. Under a concessionary amalgamation, if the borrower is insolvent and unlikely to meet its obligations under the financial arrangement, the financial arrangement is deemed to be discharged immediately before the amalgamation for the market value of the financial arrangement on the date of amalgamation (s FO 18(2)(a)(iii)). In general, this means that remission income will arise to the borrower if the value of the financial arrangement has declined (unless s FO 21 applies, which relates to economic groups). Also, generally the lender cannot claim a deduction for the amount remitted.

90. Example | Tauira 13 illustrates how s FO 18 applies on a concessionary amalgamation where the borrower is unlikely to meet its obligations under the financial arrangement.

Example | Tauira 13 – Insolvent borrower

B Co borrowed $1 million from A Co on 1 April 2022 for 2 years at an interest rate of 10% per annum, payable annually in arrears. B Co pays interest of $100,000 on 31 March 2023. By 31 December 2023, B Co is insolvent and cannot repay any of the $1 million loan or accrued interest to 31 December 2023 of $75,000. The loan has a market value of nil.

A Co and B Co are not wholly owned.

A Co and B Co amalgamate on 31 December 2023. A Co continues as the amalgamated company. The amalgamation is a concessionary amalgamation.

The following tables outline the outcome of the BPA for B Co and A Co respectively.

Outcome of the BPA for B Co

BPA item	Definition	Calculation for B Co (borrower)
Consideration	Plus all consideration that has been paid or is or will be payable **to** the person (Less all consideration that has been paid or is or will be payable **by** the person under the financial arrangement)	$1 million initial loan ($100,000) interest paid $0 market value deemed for discharge of loan
(Income)	(Less amounts the person derived under the financial arrangement in earlier income years)	0
Expenditure	Plus amounts the person incurred under the financial arrangement in earlier income years	$100,000 interest paid
Amount remitted	Plus an amount not included in the consideration paid or payable to the person because it has been remitted by the person or by law	0
BPA outcome		$1 million of income to B Co

Outcome of the BPA for A Co

BPA item	Definition	Calculation for A Co (lender)
Consideration	Plus all consideration that has been paid or is or will be payable **to** the person (Less all consideration that has been paid or is or will be payable **by** the person under the financial arrangement)	$100,000 interest received ($1 million) initial loan $0 market value deemed for discharge of loan
(Income)	(Less amounts the person derived under the financial arrangement in earlier income years)	($100,000) interest income
Expenditure	Plus amounts the person incurred under the financial arrangement in earlier income years	0
Amount remitted	Plus an amount not included in the consideration paid or payable to the person because it has been remitted by the person or by law	$1.075 million principal and accrued interest[11]
BPA outcome		$75,000 of income to A Co

A Co would need to claim a bad debt deduction for the accrued interest of $75,000 under s DB 31(2) (if they meet the requirements of that section) to offset the BPA income of $75,000.

11 See ss FO 18(7) and FO 20.

Non-concessionary amalgamations

91. On a non-concessionary amalgamation, the financial arrangement is treated as having been discharged immediately before the amalgamation for the financial arrangement's market value on the amalgamation date (s FO 18(2)(b)):
    - Where the borrower is solvent or likely to be able to meet its financial obligations under the financial arrangement, the same treatment applies as discussed at [87] relating to a solvent borrower and concessionary amalgamations. In general, this means no remission income should arise to the borrower for unpaid amounts.
    - Where the borrower is insolvent, the same treatment applies as at [89] relating to an insolvent borrower and concessionary amalgamations. In general, this means that remission income will arise to the borrower if the value of the financial arrangement has declined.

Economic groups – s FO 21

92. Section FO 21 applies to amalgamations where the companies are in the same economic group and carries the effect of s EW 46C into the amalgamation rules.
93. The core rule in s EW 46C is that where a debt remission does not cause economic income and a corresponding increase in economic wealth (and does not amount to a dividend), no debt remission income arises to the borrower. For example, no debt remission income arises when a debt is remitted within a New Zealand resident wholly owned group of companies. **Debt remission and associated amendments** Taxation Information Bulletin Vol 29, No 5 (June 2017): 105 discusses the introduction of s EW 46C in detail (see 105–109).
94. Where s FO 21 applies, the debtor is treated as having paid, and the creditor is treated as having been paid, the amount of the financial arrangement on the amalgamation date. This means that no debt remission income arises to the debtor.
95. Section FO 21 applies to both concessionary and non-concessionary amalgamations.
96. Example | Tauira 14 illustrates how s FO 21 applies when the amalgamating company and amalgamated companies are within a wholly owned New Zealand group.

Example | Tauira 14 – Financial arrangement between amalgamating companies within an economic group

B Co borrowed $1 million from A Co on 1 April 2023. The loan is interest free and repayable on 1 April 2026. By 31 December 2023, B Co is insolvent and cannot repay any of the $1 million loan. The loan has a market value of nil.

B Co and A Co have always been wholly owned New Zealand resident companies.

A Co and B Co amalgamate on 31 December 2023. A Co continues as the amalgamated company.

The following tables outline the outcome of the BPA under s FO 21 for B Co and A Co respectively.

Outcome of the BPA under s FO 21 for B Co

BPA item	Definition	Calculation for B Co (borrower)
Consideration	Plus all consideration that has been paid or is or will be payable **to** the person (Less all consideration that has been paid or is or will be payable **by** the person under the financial arrangement)	$1 million initial loan ($1 million) effect of s FO 21(2)
(Income)	(Less amounts derived by the person under the financial arrangement in earlier income years)	0
Expenditure	Plus amounts incurred by the person under the financial arrangement in earlier income years	0
Amount remitted	Plus an amount not included in the consideration paid or payable to the person because it has been remitted by the person or by law	0
BPA outcome		$0 to B Co

Outcome of the BPA under s FO 21 for A Co

BPA item	Definition	Calculation for A Co (lender)
Consideration	Plus all consideration that has been paid or is or will be payable **to** the person (Less all consideration that has been paid or is or will be payable **by** the person under the financial arrangement)	$1 million effect of s FO 21(3) ($1 million) initial loan
(Income)	(Less amounts derived by the person under the financial arrangement in earlier income years)	0
Expenditure	Plus amounts incurred by the person under the financial arrangement in earlier income years	0
Amount remitted	Plus an amount not included in the consideration paid or payable to the person because it has been remitted by the person or by law	0
BPA outcome		$0 to A Co

Other matters

Dividends (s CD 35)

97. On a concessionary amalgamation, an amount derived by an amalgamated company from an amalgamating company is not a dividend (s CD 35) if it arises because the amalgamated company:
    - acquires property of the amalgamating company; or
    - is relieved of an obligation owed to the amalgamating company.

98. Without s CD 35, the amalgamation could have dividend implications for the amalgamated company if it is a shareholder of the amalgamating company (and if no other dividend exclusions apply).

Available capital distribution amount (s CD 44)

99. Section CD 44 provides for the calculation of a company's available capital distribution amount (ACDA). Broadly, ACDA is the amount of any distribution made on the liquidation of a company that represents capital property or previously derived net capital gains.

100. An amalgamated company is treated as deriving a capital gain amount of an amalgamating company that ends its existence on amalgamation to the extent that the amalgamating company's capital gain amount (s CD 44(8)):
    - was available for distribution at the time of amalgamation; and
    - was not distributed to anyone other than the amalgamated company. For example, the capital gain amount was not distributed to a shareholder of the company as part of the amalgamation.

101. The amalgamated company is treated as deriving the capital gain amount of the amalgamating company at the time of the amalgamation.

Liquidation

102. The removal of an amalgamating company from the New Zealand register of companies under the CA 1993 on amalgamation, is a "liquidation" for tax purposes (s YA 1). The termination of an amalgamating company's existence under any other procedure of New Zealand or foreign law is also a "liquidation".

103. The liquidation of an amalgamating company is relevant as s CD 26 contains an exclusion from the dividend rules for amounts paid to a shareholder in relation to a share on the liquidation of a company. Broadly, an amount received on a liquidation of company will only be a dividend if it exceeds the amount of ASC and ACDA of the company.

Interest deductibility (s DB 8)

104. A company can deduct interest incurred on money borrowed to acquire shares in another company that is part of the same group of companies (ie, at least 66% commonly owned) if the companies are members of the same group of companies at the end of the income year (s DB 8(1)).

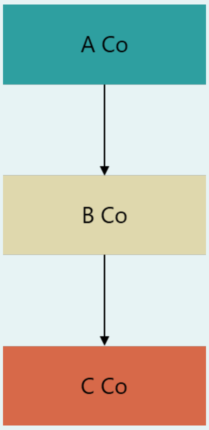
105. If a company has borrowed funds to invest in an amalgamating company, the interest is still deductible (s DB 8(3)) if:

- the amalgamation is a concessionary amalgamation; and
- the two companies were part of the same group of companies immediately before the amalgamation.

106. Example | Tauira 15 illustrates a situation where an amalgamated company can continue to deduct interest on amounts borrowed to acquire shares in a subsidiary that it amalgamates with. Example | Tauira 16 illustrates a situation where a company not involved in the amalgamation can continue to deduct interest on amounts borrowed to acquire shares in a company that ends its existence on amalgamation.

Example | Tauira 15 – Interest on amalgamated company's borrowings to acquire shares in amalgamating company

B Co borrows funds to acquire shares in C Co. B Co deducts interest on the borrowings as B Co and C Co are part of the same group of companies.



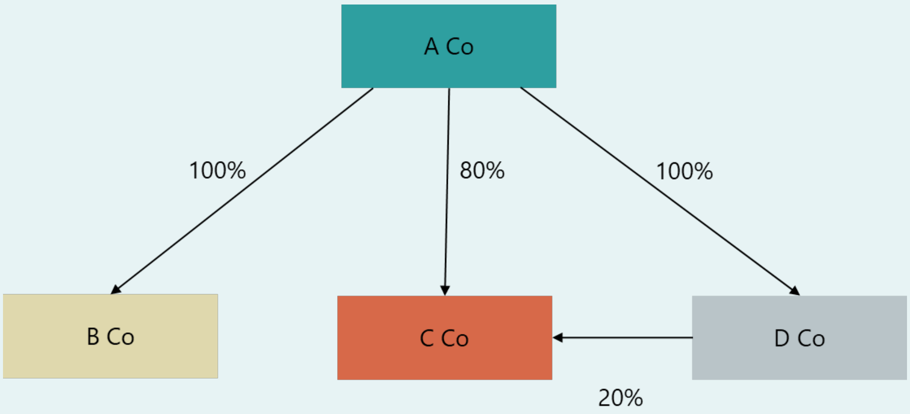
B Co and C Co amalgamate, and B Co remains as the amalgamated company. The amalgamation is a concessionary amalgamation.

B Co is able to continue deducting the interest on the borrowings under s DB 8 because:

- the amalgamation is a concessionary amalgamation; and
- B Co and C Co were part of the same group of companies immediately before the amalgamation.

Example | Tauira 16 – Company deducts interest on borrowings to acquire shares in an amalgamating company

D Co borrowed funds to acquire a 20% shareholding in C Co. D Co deducts interest on the borrowings as D Co and C Co are part of the same group of companies (D Co and C Co are 100% commonly owned by A Co).



B Co and C Co amalgamate, and B Co remains as the amalgamated company. The amalgamation is a concessionary amalgamation.

D Co is able to continue deducting the interest on the borrowings under s DB 8 because:

- the amalgamation is a concessionary amalgamation; and
- D Co and C Co were part of the same group of companies immediately before the amalgamation.

Environment restoration accounts (s EK 19)

107. Where an amalgamating company with an environmental restoration account (ERA) ends its existence on an amalgamation:
    - the contents of the ERA are transferred to an ERA of the amalgamated company on the date of amalgamation (s EK 19(a));
    - the amalgamated company is treated as having made all the payments to, and transfers from, the ERA that the amalgamating company made before the amalgamation (s EK 19(b)(i) and (ii)); and
    - the amalgamated company is treated as having received all the refunds that the amalgamating company received from the ERA before the amalgamation (s EK 19(b)(iii)).

Farming, horticultural, aquacultural and forestry business improvements on a concessionary amalgamation (s DV 14)

108. Where, if the amalgamation had not occurred, an amalgamating company would have been allowed a deduction under any one of ss DO 4, DO 5, DO 6, DO 12 and DP 3 (which relate to improvements and expenditure on certain land), the amalgamated company is allowed the deduction if:
    - the amalgamation is a concessionary amalgamation; and
    - the amalgamated company acquires land or a business from the amalgamating company.
109. The amalgamated company is allowed the deduction while it holds the land or carries on the business.

Imputation credit accounts

110. On a concessionary amalgamation, imputation credits and debits of an amalgamating company recorded before the amalgamation date are treated as if they were recorded in the imputation credit account (ICA) of the amalgamated company with effect from the original credit and debit dates (s OA 9(2)).
111. This treatment extends to credits and debits due to an amalgamating company but not recorded in its ICA before the date of amalgamation. In this situation, the credit or debit is recorded in the amalgamated company's ICA (s OA 10). However, an amalgamated company does not include a debit in its ICA for the loss of shareholder continuity in an amalgamating company as a result of amalgamation (s OA 10(3)).

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112. To carry forward imputation credits of an amalgamating company, there must be at least 66% continuity of shareholding from the date that the credit arose until the amalgamated company uses it. To determine whether continuity of shareholding exists for ICA purposes, the amalgamated company is treated for all times before the amalgamation as if it did not separately exist and was instead the amalgamating company, with the same shareholders and option holders. An amalgamated company must keep records of any imputation credits in its ICA that an amalgamating company contributed so it can determine whether continuity of shareholding is maintained for those credits.

113. Similar rules to those discussed above apply when all the companies in a consolidated group or consolidated imputation group amalgamate on a concessionary amalgamation and, as a result of the amalgamation, the group's existence ends and an amalgamated company forms.[12]

114. On a non-concessionary amalgamation, an amalgamating company's imputation credits are extinguished.

115. Example | Tauira 17 illustrates a situation where an amalgamated company can use an amalgamating company's imputation credits after amalgamation.

Example | Tauira 17 – Amalgamated company uses an amalgamating company's imputation credits

A Co and B Co amalgamate on 31 March 2024. A Co continues as the amalgamated company.

The amalgamation is a concessionary amalgamation.

A Co and B Co's shareholdings have remained the same since incorporation.

At the time of amalgamation, B Co has a credit balance in its ICA of $25,000. The entries in B Co's ICA are as follows:

Date	Description	DR	CR	Balance
28/08/23	Provisional tax		$10,000	$10,000
15/01/24	Provisional tax		$20,000	$30,000
28/03/24	Dividend paid	($5,000)		$25,000

A Co wants to attach B Co's imputation credits of $25,000 to a dividend it proposes to pay on 30 June 2024.

A Co can attach B Co's imputation credits of $25,000 if it has at least 66% continuity of shareholding from the date that the credits arose ($5,000 on 28 August 2023[13] and $20,000 on 15 January 2024)) until the date the credits are used (30 June 2024). To determine shareholder continuity, A Co is treated as if it had B Co's shareholders before the amalgamation and its own shareholders after the amalgamation.

The shareholdings of A Co and B Co are as follows:

Shareholder – voting interest	A Co (1 April 2024 to 30 June 2024)	B Co (28 August 2023 to 31 March 2024)	Continuity of voting interest
Shareholder C	30%	30%	30%
Shareholder D	20%	45%	20%
Shareholder E	50%	25%	25%
Total			75%

As the continuity of voting interest in A Co is 75%, the required shareholder continuity is met from the date the credits arose until the time A Co uses them.

12 See s OA 14.

13 See s OA 8(8), debits reduce credits in the order in which the credits arise.

Tax credits relating to attributed controlled foreign company (CFC) income

116. On a concessionary amalgamation, if an amalgamating company has a pre-amalgamation tax credit for tax paid on attributed CFC income, the tax credit is treated as a tax credit of the amalgamated company for the tax year in which the amalgamation occurs (s LK 13) if the tax credit could be made available to:

    - the amalgamated company (unless it is a company incorporated only on amalgamation); and
    - any company that has amalgamated with the amalgamated company.

117. If more than one amalgamating company contributes pre-amalgamation tax credits to the amalgamated company, the amalgamated company uses the credits in the order they arose. If the tax credits are for the same tax year, the amalgamated company can credit them in the order the amalgamated company chose if notified to the Commissioner. If the amalgamated company gave no notice, the amalgamated company uses the tax credits on a pro rata basis (s LK 14(3)).
118. An amalgamated company can only use the tax credits of another company if the other company and the amalgamated company were in a wholly owned group of companies (s LK 15).
119. Broadly, tax credits paid in relation to attributed controlled foreign company (CFC) income can be carried forward to future income years provided that 49% shareholding continuity is maintained or, if that requirement is not satisfied, no major change in the company's business occurs (ss LK 4 and LK 5). Wholly owned group companies can also use a company's tax credit relating to attributed CFC income in certain situations (s LK 6)[14]. That is, tax credits relating to attributed CFC income are subject to rules that are similar to the rules for the carry-forward and use of tax losses.
120. On an amalgamation, for the purpose of determining whether a tax credit paid in relation to attributed CFC income can be carried forward or made available to another group company, the amalgamated company is treated as if it were the amalgamating company with the same shareholder profile as the amalgamating company (s LK 12).

Non-standard balance dates

121. An amalgamated company can only use an amalgamating company's non-standard balance date if the amalgamated company had that non-standard balance date before the amalgamation, or if the amalgamated company successfully applies to the Commissioner for consent to adopt that non-standard balance date. Example | Tauira 18 illustrates how non-standard balances apply on amalgamation.

Example | Tauira 18 – Non-standard balance dates

A Co has a 31 March balance date.

B Co has a 30 June balance date.

If A Co and B Co amalgamate and A Co continues as the amalgamated company, the amalgamated company (A Co) will have a 31 March balance date unless the Commissioner consents to a 30 June balance date.

However, if B Co were the amalgamated company, it would continue to have a 30 June balance date.

Provisional tax

122. An amalgamating company's residual income tax (the amount of income tax payable after deducting tax credits but before provisional tax) is added to the amalgamated company's residual income tax for provisional tax purposes (s RC 33). For example, an amalgamating company's residual income tax is added to the amalgamated company's residual income tax for the purpose of determining:

    - whether the amalgamated company is a provisional taxpayer in the year of amalgamation (see, eg, s RC 3(3), which is the $5,000 threshold for the preceding year); and
    - the amount of provisional tax payable.

14 The group company must derive attributed CFC income from the same country in which the CFC generating the tax credit was resident (see s LK 6(3)).

123. Example | Tauira 19 illustrates how an amalgamated company calculates its provisional tax obligations.

Example | Tauira 19 – Calculating provisional tax

A Co, B Co and C Co amalgamate on 31 March 2023. A Co continues as the amalgamated company.

Each company's residual income tax for the year ended 31 March 2023 is as follows:

A Co $10,000

B Co $12,000

C Co $6,000

A Co calculates its first provisional tax instalment for the 2024 year using the standard uplift method. Under this method, the amount of provisional tax payable for the tax year is based on 105% of the person's residual income tax for the preceding tax year (here the 2023 year). A Co's residual income tax for the 2023 year is $28,000, which consists of $10,000 + $12,000 + $6,000. A Co's provisional tax payable for the tax year is $29,400 (105% of $28,000).

Fringe benefit tax

124. An amalgamating company that ceases to exist on amalgamation must file a fringe benefit tax (FBT) return to the date of amalgamation. The de minimis threshold for unclassified benefits and the threshold for paying FBT on an income basis are apportioned under the amalgamation rules.

Applying the de minimis threshold to the amalgamated company

125. The FBT rules contain a de minimis exemption that allows employers to provide unclassified benefits to employees without triggering FBT. The de minimis exemption applies where:

- the total taxable value of unclassified benefits provided to each employee is not more than:
  - $300 per quarter (for employers that pay FBT quarterly); or
  - $1,200 per annum (for employers that pay FBT annually); and
- the total taxable value of unclassified benefits provided to all employees in the last four quarters, including the current quarter, is not more than $22,500 per annum (same threshold applies to annual FBT filers).

126. Section RD 46 applies when a company that is an employer ends its existence on amalgamation, or a new company is established on amalgamation. It apportions the de minimis thresholds for the period in which the amalgamation occurs according to the number of days after (Table | Tūtohi 4) or before (Table | Tūtohi 5) the amalgamation.

Table | Tūtohi 4: De minimis threshold according to the number of days after amalgamation

Amalgamating company ends its existence on amalgamation and pays FBT on:	Amalgamating company's $22,500 annual exemption is reduced by:
Quarterly basis	$22,500 × number of days in the quarter **after** amalgamation / days in quarter
Annual basis	$22,500 × number of days in the year **after** amalgamation / 365

Table | Tūtohi 5: De minimis threshold according to the number of days before amalgamation

Amalgamated company is a new company and pays FBT on:	Amalgamated company's $22,500 annual exemption is reduced by:
Quarterly basis	$22,500 × number of days in the quarter **before** amalgamation / days in quarter
Annual basis	$22,500 × number of days in the year **before** amalgamation / 365

127. Example | Tauira 20 illustrates how s RD 46 apportions the de minimis threshold when the amalgamating company pays FBT on an annual basis.

Example | Tauira 20 – Calculation of de minimis threshold on unclassified benefits where the amalgamating company pays FBT annually

A Co and B Co amalgamate on 31 December 2023. A Co continues as the amalgamated company.

B Co pays FBT on an annual basis.

B Co has a 31 March balance date and provided unclassified benefits to its employees in the income year in which the amalgamation occurred (its 2024 income year).

To determine if B Co has to pay FBT on the unclassified benefits provided, the $22,500 de minimis threshold is reduced as follows:

$22,500 × 91[15] (number of days in the year after the amalgamation)/365 = $5,610

$22,500 – $5,610 = $16,890

That is, for the de minimis exemption to apply, the total taxable value of unclassified benefits that B Co provided in its 2024 income year to the date of amalgamation must be no more than $16,890.

Paying FBT on an income year basis – close companies

128. A close company can choose to pay FBT on an income year basis in certain situations. A close company means a company with five or fewer natural persons or trustees who hold more than 50% of the voting interests or market value interests in the company. All natural persons associated at the time are treated as one person.[16]

129. One situation where a close company can choose to pay FBT on an income year basis is where its gross PAYE and ESCT deductions in the preceding income year do not exceed a stated threshold (currently, $1 million) (s RD 60(1)(a)). To determine whether the threshold has been met, the amalgamated company is deemed to have paid the gross PAYE and ESCT that the amalgamating company paid in the income year before the income year in which the amalgamation occurred.

GST

130. An amalgamation may involve the supply of goods or services (eg, transferring an amalgamating company's assets to the amalgamated company).

131. No GST implications arise where an amalgamating company supplies any goods or services to the amalgamated company on amalgamation, provided that either of the following conditions is met:

- the amalgamated company is registered or liable to be registered for GST immediately after the amalgamation; or
- the amalgamating company is not registered or liable to be registered for GST immediately before the amalgamation.

132. Section 61A(2) of the Goods and Services Tax Act 1985 (GST Act) achieves this outcome by deeming there to be no supply of goods and services by the amalgamating company and no consideration provided by the amalgamated company for the acquisition of those goods and services. The one exception relates to mixed-use assets – see [136]).

133. If both conditions described at [131] are not met, the amalgamating company is deemed to have supplied any goods and services to the amalgamated company at their market value at the date of amalgamation (s 61A(3) of the GST Act).

134. An amalgamating company that ceases to exist on amalgamation is deemed to end its taxable period when it ceases to exist. It must file a GST return for the taxable period ending on the date of amalgamation.

135. The GST Act contains other specific modifications relating to amalgamations, as outlined below.

15 2024 is a leap year.

16 See the meaning of "close company" in s YA 1.

Mixed-use assets

136. A business can claim input tax deductions on purchases of goods and services it uses to make taxable supplies. Apportionment and adjustment rules apply in certain circumstances when a GST-registered person uses or intends to use goods and services for taxable and non-taxable purposes. Sections 21 to 21H of the GST Act contain the adjustment rules. Where goods have been transferred without GST consequences and later the use of the goods changes, the GST adjustment required is calculated as if the amalgamated company acquired the goods at the same time and for the same cost and purpose as the amalgamating company originally did (s 61A(2)(f) of the GST Act).

GST, FBT and entertainment expenditure

137. Where an amalgamating company has provided fringe benefits or incurred entertainment expenditure in the period before amalgamation and is deemed to have made a supply after amalgamation under subs (3) or (4) of s 21I in the GST Act, the supply is deemed to be made by the amalgamated company (not the amalgamating company) on that date (s 61A(4) of the GST Act).

138. Example | Tauira 21 illustrates a situation where an amalgamated company is deemed to supply entertainment because an amalgamating company incurred entertainment expenditure before amalgamation.

Example | Tauira 21 – Deemed supply of entertainment after amalgamation

A Co and B Co amalgamate on 31 March 2024. A Co continues as the amalgamated company.

Both A Co and B Co are registered for GST on the date of amalgamation. This means no GST implications arise from any goods or services that B Co supplied to A Co on amalgamation (eg, in transferring B Co's assets to A Co).

Before the amalgamation B Co incurred entertainment expenditure of $10,000 in its 2024 income year (of which 50% is deductible).

Under s 21I(4)(a) of the GST Act, B Co is treated as having supplied entertainment with a value equal to the amount of the deduction prevented by ss DD 1 and DD 2 of the Act ($5,000). Section 21I(4)(b) deems the time of supply to be the earlier of the date B Co furnishes its 2024 tax return and the date by which it must furnish its 2024 tax return.

B Co filed its tax return on 1 July 2024 (due on 7 July 2024). B Co is deemed to have supplied entertainment on 1 July 2024, a date after it ceased to exist.

A Co is deemed to have supplied the entertainment on 1 July 2024. A Co must return the GST component of that supply ($652, being 3/23 × $5,000) as output tax in its GST return that covers the July 2024 period.

Bad debts

139. A further modification applies where, if the amalgamation had not occurred, an amalgamating company would have been entitled under s 26 of the GST Act to a deduction against output tax for writing off a bad debt or deemed to have made a taxable supply on recovery of a bad debt. In these circumstances, the amalgamated company is entitled to that deduction or will be charged with that output tax (s 61A(5) of the GST Act).

Registration

140. A person carrying on a taxable activity is liable to register for GST if the total value of supplies (ie, the amount of money made from selling goods or services) made in New Zealand was at least $60,000 in the last 12 months or is expected to be at least $60,000 in the next 12 months (s 51(1)(a) of the GST Act).

141. For the purposes of establishing whether an amalgamated company is liable to register for GST under s 51(1)(a) of the GST Act, all the supplies the amalgamating company made before the amalgamation are deemed to have been made by the amalgamated company (s 61A(6) of the GST Act).

142. An amalgamating company that ceases to exist on amalgamation is deemed to end its taxable period when it ceases to exist. It must file a GST return for the taxable period ending on the date of amalgamation (s 15E(3) and (4) of the GST Act).

Administrative matters

143. The amalgamated company must give notice of the amalgamation to the Commissioner within 63 working days of (s 75 of the TAA):
    - delivering the amalgamation documents to the Registrar of Companies (or the equivalent procedure if the amalgamation occurs under foreign law); or
    - in the case of an amalgamation of building societies, registering the notice of the transfer of all engagements.
144. The amalgamated company notifies the Commissioner of an amalgamation by filing a **Declaration of an amalgamation – IR 432**.
145. Companies wishing to opt out of the concessionary amalgamation rules must notify the Commissioner of this decision within 63 working days as discussed at [143] (s 75 of the TAA).
146. The amalgamated company must make a return of income for the amalgamating company and the tax year in which the amalgamation takes place (s 76(b) of the TAA).
147. If the amalgamation occurs on the last day of the income year, the amalgamating company's final income tax return is for the full income year (including the day of the amalgamation).

References | Tohutoro

Legislative references | Tohutoro whakatureture

Building Societies Act 1965, s 33

Companies Act 1993, ss 220, 221, 222, 225, parts 13 and 15

Income Tax Act 2007, ss CB 6A, CB 9 to CB 11, CB 14, CD 35, CD 44, CG 2C, CV 4, CW 9, CW 10, DB 8, DB 31, DD 1, DD 2, DO 4 to DO 6, DO 12, DP 3, DV 14, DV 15, EE 41, EK 19, EW 31, EW 42, EW 46C, FO 1 to FO 21, GB 21, GC 1, HA 23, HF 3, LK 4 to LK 6, LK 12 to 15, OA 8, OA 9, OA 10, OA 14, OB 9, RC 3, RC 33, RD 46, RD 60, YA 1 ("amalgamation", "liquidation"), subpart EB

Goods and Services Tax Act 1985, ss 15E, 21 to 21H, 21I, 26, 51, 61A

Tax Administration Act 1994, ss 75, 76

Other references | Tohutoro anō

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IS 25/09: Tax treatment of losses on amalgamation (April 2025)
taxtechnical.ird.govt.nz/interpretation-statements/2025/is-25-09

QB 25/06: How does an amalgamated company calculate its available subscribed capital following an amalgamation? (April 2025)
taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2025/qb-25-06

IS 25/11: Income tax – Partnerships (including limited partnerships) – general guidance

Issued | Tukuna: 4 April 2025

This interpretation statement provides general guidance on the income tax treatment of partnerships. Most of this statement is relevant to both general and limited partnerships. The rules are largely the same for both types of partnership.

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

Introduction | Whakataki

1. This statement provides general guidance on the income tax treatment of partnerships. It does not address the GST treatment of partnerships. Partnerships are treated differently under the Goods and Services Tax Act 1985.
2. Most of this statement is relevant to limited partnerships as well as general partnerships. This statement explains where the rules differ for limited partnerships and, in particular, contains a discussion of the deduction limitation rule, which applies to only limited partnerships (see from [399]).
3. This statement also references existing guidance issued on specific partnership issues.

Tax and non-tax definitions of "partnership" differ

4. The following briefly discusses the different types of partnerships recognised by the law and the coverage of definitions used in the tax and non-tax contexts.

Definition of partnership under general partnership law

5. The general (non-tax) law of partnerships recognises two types of partnership:
   - partnerships (referred to as general partnerships in this statement); and
   - limited partnerships.

General partnerships

6. Under general law, a partnership (general partnership) is defined as the relationship that exists between persons carrying on a business in common with a view to profit. A general partnership does not have a separate legal personality. The law relating to general partnerships is in the Partnership Law Act 2019 (PLA).

Limited partnerships

7. Under general law, the Limited Partnerships Act 2008 (LPA) provides a regulatory regime for limited partnerships. To be a limited partnership under the LPA, a limited partnership must be registered under the LPA and meet certain requirements.
8. Under the LPA, a limited partnership is recognised as a separate legal person. A limited partnership that is registered under the LPA is not subject to the PLA.[1]
9. A limited partnership must have at least one general partner and at least one limited partner.
10. A limited partnership must have at least one general partner who satisfies the requirement in s 8(4) of the LPA. This requires that the general partner, or a director or partner of a general partner (if the general partner is a company or partnership respectively), lives in New Zealand or lives in an "enforcement country"[2] and is a director of a body corporate that is incorporated in that country under a law that is equivalent to the Companies Act 1993. See s 8(4) of the LPA for more details.
11. A limited partnership must always have a registered office in New Zealand.[3]
12. The general partner is responsible for the management of the limited partnership. The general partner is liable with the limited partnership for the debts and liabilities of the partnership.

1 Section 9 of the PLA.

2 "Enforcement country" means a country prescribed in regulations for this purpose. As of 2024, Australia is the only country to be so prescribed.

3 Section 67 of the LPA.

13. Under the LPA, limited partners enjoy limited liability. Limited partners are not liable for the debts and liabilities of the limited partnership,[4] provided they do not take part in the management of the limited partnership.[5] The LPA states that a limited partner must not take part in the management of the limited partnership.[6]

14. Similar limited liability partnership structures exist overseas.[7] Overseas limited partnerships can also be registered under the LPA. However, partnerships registered as limited partnerships and partnerships registered as overseas limited partnerships are provided for separately under the LPA.

Definition of partnership for income tax purposes

15. "Partnership" is specifically defined for income tax purposes.[8] The income tax definition is wide and includes general and limited partnerships.

16. At its core, the income tax definition adopts the basic test that is also used under the general law of partnerships: a partnership is the relationship that exists between persons carrying on a business in common with a view to profit.[9]

17. In addition, for income tax purposes, a partnership includes the following:
    - A limited partnership registered under the LPA, provided that it is not listed on a recognised exchange.[10]
    - A partnership that is formed or incorporated outside New Zealand, provided it is not treated as a separate legal entity under the laws (other than taxation laws) of the foreign jurisdiction where it is established,[11] with:
        - one or more general partners who are liable for all the debts and liabilities of the partnership; and
        - one or more limited partners who have only limited liability for the debts and liabilities of the partnership;
    - Joint ventures, if the joint venture members choose to be treated as a partnership for income tax purposes;[12] and
    - Co-owners of property (other than persons who are co-owners only because they are shareholders of the same company, or settlors, trustees, or beneficiaries of the same trust), if they choose to be treated as a partnership for income tax purposes.

18. This statement does not consider overseas limited partnerships or listed limited partnerships.[13] This statement focuses on unlisted limited partnerships registered under the LPA.

19. The wide income tax definition of partnership means that a provision in the ITA that applies to a partnership or its partners, may also apply to the above entities or relationships.

20. "Partner" has a corresponding meaning.[14] It includes a person who is a member of a general partnership, limited and general partners of limited partnerships, and a joint venturer or co-owner, if they make the relevant choice to be treated as a partnership.

4 However, property that the limited partners have contributed to the partnership can be used to pay partnership debts and liabilities.

5 Section 31 of the LPA.

6 Section 20(1) of the LPA.

7 One purpose of the LPA is to give the business community in New Zealand the option of a flexible and internationally recognised business structure similar to limited partnerships in use in overseas jurisdictions (s 3 of the LPA).

8 Partnership is defined in s YA 1.

9 This doesn't mean that partnership has exactly the same meaning as it does under the PLA. Paragraph (a) of the definition of partnership in s YA 1 states that partnership means a group of two or more persons who have, between themselves, the relationship described in s 8(1) of the PLA. The definition in the PLA goes on to exclude certain entities and relationships that are included in the definition of partnership under the ITA.

10 Paragraph (d) of the definition of partnership in s YA 1 includes a limited partnership. Limited partnership is also defined in s YA 1. Under that definition, a limited partnership is a limited partnership registered under the LPA, but listed limited partnerships are excluded.

11 The definition of limited partnership in s YA 1 excludes a "foreign corporate limited partnership", which is defined as an "overseas limited partnership" that is treated as a separate legal entity under the laws (other than taxation laws) of the foreign jurisdiction where it is established. An overseas limited partnership included for tax purposes within the definition of limited partnership is not quite equivalent to a limited partnership registered under the LPA as the latter has a separate legal personality.

12 The choice appears to arise by virtue of the definition of partnership itself. No other provision appears to set out formal election procedures. In the Commissioner's view, joint venturers or co-owners will make such a choice if they file a joint return of income as a partnership.

13 For income tax purposes, a listed limited partnership is treated as a company. The definition of "company" in s YA 1 includes a "listed limited partnership".

14 Partner is defined in s YA 1.

Transparency

21. A key feature of the income tax treatment of partnerships (general and limited) is that they are treated as being transparent for some purposes.

22. Transparency can apply to a limited partnership, despite a limited partnership being a separate entity.

Transparency means taxing provisions are applied at the partner level

23. Transparency means that taxing provisions generally apply to a partner, not the partnership.

24. An alternative view, that taxing provisions are applied at the partnership level and amounts simply divided between partners, was considered. This alternative view and the reasons why the view is not accepted are discussed at [98].

25. The transparent tax treatment is provided by s HG 2(1):

> **HG 2 Partnerships are transparent**
>
> *Look-through in accordance with share*
>
> (1) For the purposes of a partner's liabilities and obligations under this Act in their capacity of partner of a partnership, unless the context requires otherwise,—
>
> (a) the partner is treated as carrying on an activity carried on by the partnership, and having a status, intention, and purpose of the partnership, and the partnership is treated as not carrying on the activity or having the status, intention, or purpose:
>
> (b) the partner is treated as holding property that a partnership holds, in proportion to the partner's partnership share, and the partnership is treated as not holding the property:
>
> (c) the partner is treated as being party to an arrangement to which the partnership is a party, in proportion to the partner's partnership share, and the partnership is treated as not being a party to the arrangement:
>
> (d) the partner is treated as doing a thing and being entitled to a thing that the partnership does or is entitled to, in proportion to the partner's partnership share, and the partnership is treated as not doing the thing or being entitled to the thing.

26. As stated above, the transparency provided by s HG 2(1) means that taxing provisions generally apply to a partner, not the partnership. This can be seen, for example, in the context of a taxing provision such as s CB 6. Section CB 6 applies to an amount that a "person" derives from disposing of land. In the context of a partnership, the "person" referred to in s CB 6 can only refer to a partner, not the partnership, because s HG 2(1)(b) and (d) treat the partner, and not the partnership, as holding the land that the partnership holds and as doing a thing that the partnership does.

27. Section CB 6 also requires the person to have acquired the land for a purpose or intention of disposing of it. Again, in the context of a partnership, the "person" can only refer to a partner, not the partnership, because s HG 2(1)(a) treats the partner, and not the partnership, as having the partnership's purposes and intentions.

28. See also from [345], where the application of transparency is illustrated in detail in relation to another section, s CB 9.

29. The specific tax treatments under s HG 2(1) that give effect to the transparent tax treatment are discussed from [54].

30. Broadly, the result of these tax treatments is that income derived by the partnership, from its business or from partnership property, is treated as being derived directly by the partners, and not by the partnership.

31. Similarly, s HG 2(1) results in expenditure incurred by the partnership being incurred directly by the partners, and not the partnership, which means deductions can be claimed by the partners. Deductions are discussed further at [118].

32. The transparent tax treatment of partnerships can be contrasted with the taxation of companies, where income is derived and subject to tax firstly when derived by the company and again when distributed to the shareholders (with relief from double taxation provided through imputation credits). With partnerships, partners are treated as deriving and incurring amounts directly.

33. The transparent tax treatment of partnerships means the core provision concepts in subpart BC such as "net income", "net loss", and "taxable income" are relevant to the partners, not the partnership. The transparent tax treatment of partnerships means net income, or a net loss, can arise only for the partners, not the partnership. This means, for example, a partnership cannot carry forward or share a tax loss.[15]

34. Despite the transparent tax treatment, and despite a general partnership not being a separate entity, partnerships are given their own IRD number for return filing and other administrative purposes. Return filing is discussed further at [129].

Purposes for which transparency applies

35. The opening wording of s HG 2(1) provides some limitations on transparency. Section HG 2(1) begins with the words:

> (1) For the purposes of a partner's liabilities and obligations under this Act in their capacity of partner of a partnership, unless the context requires otherwise,—

36. Different aspects of these introductory words are discussed further below.

For the purposes of a partner's liabilities and obligations

37. The transparent tax treatment of partnerships applies only for the purposes of a **partner's** liabilities and obligations under the ITA.[16]

38. This means that where a taxing provision is applied to a transaction involving a partnership, transparency generally only applies if the taxing provision is being applied in relation to the partnership side of the transaction. If a taxing provision is being applied to the other party to the transaction, transparency generally does not apply.[17]

If the context requires otherwise

39. The transparent tax treatment of partnerships **does not apply if the context requires otherwise**. The phrase "unless the context requires otherwise" in s HG 2(1) is consistent with the intention that transparency would not apply in all cases (although it generally will apply). This intention can be seen from the officials' report on the Limited Partnerships Bill. The report noted that the partnership rules attempt to provide a reasonable balance between the integrity and accuracy of the flow-through mechanism provided by the aggregate approach, and the administrative and compliance convenience of the entity approach.[18]

40. The phrase "unless the context requires otherwise" is often used in legislation in definition sections. Used in that context, the courts have sometimes said that there is generally a high threshold before the context requires otherwise.[19] However, firstly, s HG 2(1) is not a definition section and, more importantly, there is a clear intention that transparency would not apply in all cases. Therefore, in the Commissioner's view, in the context of s HG 2(1), the phrase "unless the context requires otherwise" does not involve a high threshold.

41. The ITA provides little guidance about when transparency applies and when it does not. Sometimes the ITA specifies in a provision that transparency does not apply. For example, s HG 4 applies where "the partnership's business *ignoring section HG 2* will not continue to be carried on in partnership". However, in other situations, there can be ambiguity and difficulty in determining whether transparency applies.

42. The Commissioner's view is that whether transparency applies in the context of a particular provision must be determined by applying a purposive interpretation of the particular provision. This means considering the ordinary meaning of the words of the provision in light of the context and purpose of those words.[20] It should be asked whether applying transparency in the context of the provision would be consistent with a purposive interpretation. This is illustrated below in relation to some examples.

15 The IR7 form for the joint return of partnership income may use language such as total income or loss after expenses. However, the IR7 is using these terms in a simplified way to reflect aggregate amounts derived and incurred by the partners. The wording used on the form is not determinative of how partnerships are taxed.

16 Implicitly, s HG 2 also applies for the purposes of the partnership's liabilities and obligations under the ITA in the sense that s HG 2 results in the partnership not having liabilities and obligations that it otherwise might have had. This is necessary to avoid double taxation.

17 A possible exception is in relation to a provision imposing a withholding tax obligation on a payer making a payment to a partnership, as the withholding would relate to the underlying income tax liabilities of the partners.

18 Limited Partnerships Bill - officials' report on tax aspects of parts 5 and 6 of the bill (Policy Advice Division, Inland Revenue, November 2007) at 8.

19 *Police v Thompson* [1966] NZLR 813; *NZ Ostrich Export Co v CIR* (2006) 22 NZTC 19, 182.

20 Section 10 of the Legislation Act 2019.

43. Before it was amended, an example where the context previously required transparency to not apply was in the test for the application of rollover relief from the bright-line rule in s FD 1.[21] A requirement for rollover relief to apply under s FD 1 was that the transferor and transferee of property are associated. One of the types of association that was intended to satisfy this test was association between a partner and their partnership. Although it might seem obvious that association would be tested as between the partner and partnership, identifying this as the appropriate test of association required the transparency of partnerships to be ignored (the alternative would have been to test association between a person and the partners of the partnership).

44. Before it was amended, another example where the context required transparency to not apply was in s DC 3, which referred to a partnership carrying on business.[22] On its face, a partnership carrying on business is inconsistent with s HG 2(1)(a), which states that partners are treated as carrying on an activity (which includes a business) carried on by a partnership, and the partnership is treated as not carrying on the activity. In determining whether the context requires otherwise for this provision, the context and purpose of s DC 3 must be considered. The purpose of this provision is to allow a person (who may be a continuing partner of a partnership or a person carrying on the business in their own name following the dissolution of a partnership) a deduction for expenditure relating to a pension paid to a former partner. The deduction is subject to there being continuity of the business carried on by the partnership in which the former partner was a partner and the business now being carried on. If transparency had been applied in this context, the requirement that the partnership had carried on the business could not have been satisfied, and the purpose of s DC 3 would not have been achieved. Therefore, the purpose of the provision supported an interpretation that the context required otherwise for s DC 3.

45. An example that is sometimes given for where the context requires otherwise is in relation to resident withholding tax exempt status (RWT-exempt status).[23] Under s RE 30(3), for the purposes of the RWT rules, a payment made to a member of a body (which includes a partner of a general partnership) in the member's capacity as a member and in the course of carrying on the taxable activity of the body is treated as a payment made to the body and not to the member. This is more accurately described as an example of the transparency created by s HG 2(1) being modified, as opposed to an example of the context requiring otherwise (this is because s RE 30(3) is predicated on the payment being made to the member to begin with).

Only in their capacity of partner

46. The transparent tax treatment of partnerships applies for the purposes of a partner's liabilities and obligations **only in their capacity of partner** of a partnership. This limits the application of s HG 2(1) to liabilities and obligations that result from the person being a partner. For example, a partner is treated as being in the business of dealing in land if the partnership is in that business. If the partner disposes of an interest in partnership land, the treatment of the partner as being in the business of dealing in land will apply to the disposal. However, the treatment of the partner as being in the business of dealing in land will not apply to a disposal of land the partner owns in a capacity other than that of partner in the partnership.[24]

47. The reference to "capacity" in s HG 2(1) does not mean a person who is a partner is taxed as if they were two entirely separate persons. The different capacity treatment is not as extensive as it is for trustees, for example.[25] In s HG 2(1), the reference to capacity is simply limiting the application of the look-through treatments provided by the subsection.

48. It follows that the taxation of amounts a person has as a partner can be affected by the person's own characteristics and non-partnership activities, provided they are not overridden by those inherited from the partnership. One example is a partner's residency (see [298]).

21 An amendment was made to clarify that for the purposes of determining association under s FD 1(1)(a) and a transfer between a partner and a partnership, s HG 2 (Partnerships are transparent) is ignored and association is determined under s YB 12. See cl 48(4B) of the Taxation (Annual Rates for 2024–25, Emergency Response, and Remedial Measures) Bill.

22 An amendment was made to clarify that s HG 2(1) does not apply for the purposes of s DC 3. See cl 31 of the Taxation (Annual Rates for 2024–25, Emergency Response, and Remedial Measures) Bill.

23 New legislation: Taxation (Limited Partnerships) Act 2008 *Tax Information Bulletin* Vol 20, No 8 (September/October 2008): 6.

24 This was noted in New legislation: Taxation (Limited Partnerships) Act 2008 *Tax Information Bulletin* Vol 20, No 8 (September/October 2008): 5.

25 Under s YA 5 (General rule: capacity of trustees) a person who is acting as a trustee of a trust is acting in a capacity that is separate from their other capacities.

49. Another example is in the context of s CB 9(1). Under s CB 9(1), an amount a person (who may be a partner of a partnership) derives from disposing of land (including an interest in partnership land) is income of the person if they dispose of the land within 10 years of acquiring it and, at the time they acquired the land, they carried on a business of dealing in land (including in their non-partner capacity), whether or not the land was acquired for the purpose of the business. This section could apply to a partner and their share of the proceeds from the disposal of partnership land. This demonstrates that the taxation of amounts a person has as a partner can be affected by the person's own characteristics and non-partnership activities. For further discussion of s CB 9, see [345].

50. Another example is in the context of the FIF rules. A partner may hold some FIF investments as a partner of a partnership and other FIF investments separately from the partnership. The application of the FIF rules depends on thresholds that consider a person's total investments in FIFs, whatever the capacity in which investments are held (for further discussion, see [388]).

51. An example of a conflict between a characteristic inherited from a partnership and a personal characteristic arises in relation to the partnership's purpose or intention for property. Because a partner cannot deal with property separately from the other partners, a partner is not able to genuinely hold a purpose or intention (in relation to the disposal of the land by the partnership) that is inconsistent with the purpose or intention of the partnership (see [64]). This is illustrated in Example | Tauira 2.

Other legislation

52. Section HG 2(1) does not affect the partners' rights or obligations under other tax acts (for example, under the Goods and Services Tax Act 1985) or under general law.

53. The specific treatments under s HG 2(1) that achieve transparency are discussed next.

Partner is treated as carrying on an activity carried on by the partnership

54. A partner is treated as carrying on an activity carried on by the partnership and the partnership is treated as not carrying on the activity. An activity includes a business. Therefore, if the partnership is carrying on a business, every partner (including a limited partner of a limited partnership) is treated as carrying on the business, instead of the partnership.

55. This only applies to a partner in their capacity as a partner of the partnership. Therefore, if the partnership carries on a business of dealing in land, a partner will, as a result, only be treated as carrying on a business of dealing land in their capacity as a partner. The partner will not, as a result, be treated as carrying on a business of dealing in land in relation to a disposal of land they hold in their non-partner capacity.[26]

56. Because the partners are treated as carrying on the business, s CB 1 (the business income taxing provision in the ITA) is applied to each partner, not the partnership. This, in combination with other specific treatments under s HG 2, results in each partner deriving the income directly (rather than receiving a distribution from the partnership).

57. This result, that partners are treated as carrying on the business and deriving business income directly, applies to limited partners of limited partnerships. This is even though under general law, a limited partner is prohibited from taking part in the management of the limited partnership (and, therefore, the business).[27] Section HG 2 treats a limited partner as carrying on the business for the purposes of determining a partner's liabilities and obligations under the ITA.

58. An important implication of this treatment is that a partner, including a non-resident limited partner who is not involved in the management of the business, can have business income with a source in New Zealand. Source is discussed further from [301]. This is illustrated in Example | Tauira 1

26 However, the partner may still be taxable under s CB 9 on the basis that they were associated with a person (the partnership) that was carrying on a business of dealing in land. See from [369].

27 Section 20 of the LPA.

Example | Tauira 1 - Limited partner treated as carrying on business in New Zealand

Facts

A limited partnership carries on a business in New Zealand. The partnership has one general partner based in New Zealand and two limited partners who are resident in South Korea. In the 2024 tax year, the limited partnership has $200,000 of business income.

Tax treatment

This income is treated as being derived by the limited partners under s CB 1 (the business income taxing provision in the ITA) because the limited partnership is transparent for income tax purposes. The income is business income in the hands of the limited partners because, as partners in a partnership, the limited partners are treated as:

- carrying on the business carried on by the limited partnership; and
- being entitled to amounts the partnership is entitled to.

The income has a source in New Zealand because the income is derived from a business carried on in New Zealand.[28] Because the limited partners are treated as carrying on the business, which is carried on in New Zealand, the income has a source in New Zealand for the limited partners.

Because the income has a source in New Zealand, the income can be part of the limited partners' assessable income.[29]

Partner is treated as having intentions and purposes of the partnership

59. For income tax purposes, under s HG 2, every partner is treated as having the intentions and purposes of the partnership.[30] The determination of the partnership's intentions and purposes is discussed from [72].

60. Intentions and purposes can be important for various taxing provisions. Section s CB 6 (Disposal: land acquired for purpose or with intention of disposal) is used as an example in the following discussion.

61. When applying s CB 6 in the context of a disposal of partnership land, the question is whether the **partner** satisfies the requirements of the section. The requirements of the section could not be satisfied by the partnership. This is because, by virtue of s HG 2, it is the partner, not the partnership, who is treated as holding and disposing of an interest in the land (being the part of the land that the partner is treated as holding in proportion to the partner's partnership share[31]). Also, under s CB 6, only the partner can satisfy the intention or purpose requirement because, by virtue of s HG 2, the partner is treated as having the partnership's purpose or intention in relation to the land, and the partnership is treated as not having that purpose or intention.

62. The partner is treated as having the intentions or purposes of the partnership that existed on the date the partner acquired their interest in the land, which would be:
    - if the partner acquired their interest in the land when the land was acquired by the partnership (by being a partner at that time), on the date the partnership acquired the land; or
    - if the partner acquired their interest in the land by acquiring a partnership share from existing partners, on the date they acquired the partnership share (unless the safe harbour rule in s HG 5 applies – discussed from [188]).

63. Usually, the intentions or purposes of the partnership will not have changed. Partnership intentions or purposes for a new partner are discussed further from [66]. For further discussion of changes in partners, see from [158].

28 Section YD 4(2)(a).

29 Section BD 1(4) and (5).

30 Section HG 2(1)(a).

31 "Partnership share" is defined in s YA 1 as meaning, for a particular right, obligation, or other property, status, or thing, the share that a partner has in the partnership.

64. On the acquisition of partnership property, generally a partner cannot hold an intention or purpose (in relation to the disposal of the property by the partnership) that is separate from the partnership. This is because a partner cannot deal with partnership property separately from the other partners.[32] The partners must make decisions jointly, so a partner can genuinely hold only the common purpose of the partnership in relation to the disposal of the property by the partnership. An exception from this rule is discussed from [80].

65. The attribution of the partnership's purpose to a partner is illustrated in Diagram | Hoahoa 1.

Example | Tauira 2 – Partner treated as having the partnership's intention

Facts

A general partnership has three partners, partners 1 to 3, with equal partnership shares.[33] Within an email conversation, partners 1 to 3 discuss purchasing land together that has come up for sale in their area for $900,000. Partners 1 and 2 want to buy the land and sell it for a profit. Partner 3 wants to buy the land and use it to provide rental accommodation. The partners all agree to buy the land. At the time, partner 3 goes along with the purchase in the hope of later convincing the others to use the land to provide rental accommodation.

The partnership agreement states that where partners cannot agree about the sale of a substantial partnership asset, a decision can be made by taking a poll, based on the majority view measured by partnership share (see [73]).

The partnership later sells the land for $1,200,000, making a $300,000 profit.

Tax treatment

Each partner derives income of $400,000 from the sale of the property under s CB 6 (Disposal: land acquired for purpose or with intention of disposal). This is because each partner is treated as having acquired their interest in the land for a purpose or intention of disposing of it. Each partner is allowed a deduction of $300,000 for the cost of acquiring their interest in the land.

In this example, the purpose or intention of the partnership on acquisition can be determined from the purpose or intention of the majority. The majority, partners 1 and 2, had a purpose of resale when the land was acquired. For income tax purposes, partner 3 is treated by s HG 2(1)(a) as having the purpose or intention of the partnership. The fact the partner 3 did not want to dispose of the land does not affect the outcome.

Variation

If the situation was reversed, and partners 1 and 2 wanted to use the land to provide rental accommodation and partner 3 wanted to sell it for a profit, then all three partners would have the purpose of holding the land to provide rental accommodation.

Partnership purpose or intention for a new partner

66. When a new partner acquires a partnership share, they will be treated under s HG 2 as acquiring interests in the partnership's property. Assuming the safe harbour rules do not apply,[34] the partner will be treated as having the purpose or intention that the partnership has for the property on the date the partner acquires their partnership share. The partnership's purpose or intention for the property on this date will usually be the same as the partnership's original purpose or intention for the property, but it could be different. If the partnership's purpose or intention is different, the entering partner will have the new purpose or intention.

32 In *CIR v Boanas* (2008) 23 NZTC 22,046 at [68], the High Court did not exclude the theoretical prospect of an individual partner being able to establish purposes and intentions different to the other partners but noted that it would be a very limited exception. The High Court stated that a partner could not be at a tangent to what the partnership rationale was, except in the most unusual of circumstances that might arguably amount to a breach of fiduciary obligations to the remaining partners.

33 The meaning of "partnership share" is discussed at [].

34 The safe harbour rules and changes in partners generally is a topic considered in more detail from [157]

67. For a new purpose or intention to replace an earlier purpose or intention, the new purpose or intention would need to be definite. Vague ideas or possibilities would not be enough to displace an earlier established purpose or intention.[35] The Commissioner does not expect a partnership to intensively examine whether the partnership's purposes or intentions have changed every time there is a change in partners. A new purpose or intention would, based on the factors discussed at [72] and [75], normally be apparent to the partnership without intensive examination.

68. This means it is possible for different partners who have acquired partnership shares at different times to have different purposes in relation to partnership property. This is consistent with partners potentially having different acquisition dates and cost bases for partnership property.

69. An alternative interpretation on this point, that the new partner would be treated as having the partnership's original purpose or intention, was considered. However, this alternative interpretation does not have sufficient regard to the identity of the property that would be subject to tax on disposal. A taxing provision such as s CB 6 will be applied to the partner and the interest in property that the partner is treated as holding. Therefore, it is relevant to ask what the partnership's purpose or intention was when the partner acquired their interest in the partnership property, not when the partnership originally acquired the property as a whole.

70. The determination of the partnership purpose or intention for a new partner is illustrated in Example | Tauira 3.

Example | Tauira 3 – Purpose on acquiring another partner's interest in land

Facts

Partnership A is a general partnership with three partners (partners 1 to 3) with equal partnership shares.

The partnership acquires land for $900,000. The partnership originally acquires the land to derive income from leasing the land, so acquires the land on capital account.

A few years later, partner 1 thinks they should sell the land and invest elsewhere. However, partners 2 and 3 disagree.

Partner 1 convinces partner 2 to sell their partnership share to a new partner, partner 4, who agrees with partner 1 that the land should be sold. Later that day, in a meeting of the partners, a partnership resolution is passed, which notes the transfer of the partnership share and records the new intention for the partnership to sell the land. The market value of the land at this time is $1.2 million, and the amount paid by partner 4 for the partnership share included $400,000 for the one-third share in the land. For the purposes of this example, it is assumed that the safe harbour rules do not apply. The safe harbour rules are discussed from [181].

With partner 4 acquiring partner 2's partnership share, the partnership's intention with respect to the land changed, as reflected in the resolution.

One year later, the land is sold for $1.5 million to a third party.

Tax treatment

When partner 2 disposes of their partnership share to partner 4, partner 2 is treated as disposing of their share in the land. The amount received by partner 2 for the land is not taxable under s CB 6 because partner 2 is treated as having acquired their share in the land on capital account (because that was the partnership's intention when partner 2 was treated as acquiring their interest in the land as partner).

When the land is sold to the third party for $1.5 million, partners 1, 3 and 4 are treated as disposing of their interests in the land. For partners 1 and 3, no tax arises from this disposal under s CB 6 because, like partner 2, they are treated as having acquired their interests in the land on capital account.

However, partner 4 has income under s CB 6. When partner 4 acquired their interest in the land, the partnership's purpose or intention for the land was to sell. Partner 4 is treated under s HG 2 as having this purpose or intention. Therefore, partner 4 has income of $500,000 (⅓ x $1.5 million) under s CB 6. Partner 4 is allowed a deduction for the $400,000 cost of acquiring the land.

35 *Jurgens & Doyle v CIR* (1990) 12 NZTC 7,074 (HC) at 7,081.

71. In Example | Tauira 3 the partnership's purpose changed from holding land on capital account to revenue account, but the reverse scenario could also occur with the result that a new partner does not share an original revenue account purpose.

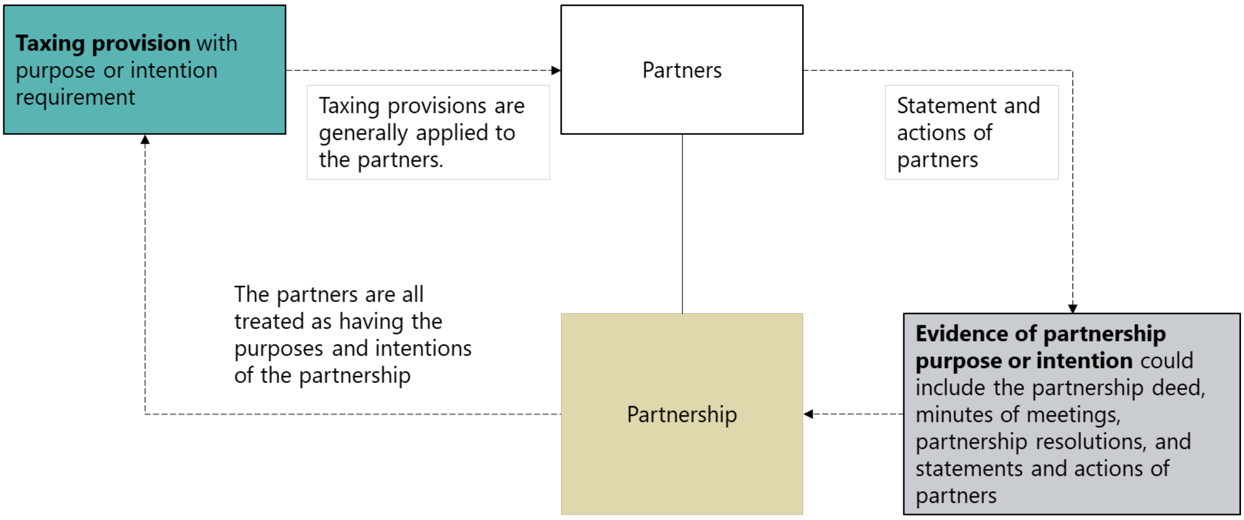
Determining the purpose or intention of a general partnership

72. A general partnership can have a purpose or intention based on purposes or intentions agreed by the partners. The purposes or intentions of a general partnership will often be evident from the partnership agreement (especially in the case of special purpose partnerships) or from minutes of meetings and resolutions of the partners or directors of the partners. It may also be necessary to consider communications between partners, the conduct of relevant parties or surrounding circumstances. In some cases, evidence given by the partners who are involved in the management of the business will be particularly relevant.[36]

73. Where differences exist between partners, the purpose or intention of a partnership on a matter might be that held by the majority of the partners.[37]

74. The determination of the partnership's purpose or intention and the attribution of this purpose or intention to the partners is illustrated in Diagram | Hoahoa 1.

Diagram | Hoahoa 1 – Determination and attribution of partnership purpose or intention



Determining the purpose or intention of a limited partnership

75. Like a general partnership, the purposes or intentions of a limited partnership will often be evident from the partnership agreement (especially in the case of special purpose partnerships), minutes of meetings and resolutions of the general partner or directors of the general partner. In some cases, it may also be necessary to consider communications between partners (especially the general partner), the conduct of relevant parties or surrounding circumstances.

76. In determining whether a limited partnership has a particular purpose, the relevance of statements, for example, made by limited partners may be affected by the fact limited partners are generally prohibited from taking part in the management of the limited partnership. However, some partner activities, listed in sch 1 of the LPA, do not constitute taking part in the management of the limited partnership. One example is taking part in a decision about whether to approve or veto investments proposed to be made by the limited partnership:

- if the value of the investments would be more than half the value of the limited partnership's assets before the investment; or
- as a member of an advisory committee of the limited partnership.

36 The facts in *CIR v Boanas* (2008) 23 NZTC 22,046 (HC) provide an example of this. In that case, all four partners were found to be effectively of one mind. Two of the partners discussed all initiatives thoroughly, and while the other two partners were informally involved, the other partners tended to go along with the proposals the first two partners advanced.

37 This is consistent with s 51(1) of the PLA, which states any difference about ordinary matters connected with the partnership business may be decided by a majority of the partners. The way in which decisions are made about ordinary matters could also be modified by agreement. Section 35 of the PLA states that the mutual rights and duties of partners (which includes how decisions are made) may be varied by the consent of all the partners (for instance, in the partnership agreement).

77. Therefore, the relevance of statements, for example, made by limited partners in determining the purpose of the partnership may depend, among other things, on the size of a transaction and whether the partners are members of an advisory committee.
78. Where a transaction does not involve limited partners, statements or actions of the general partner (who is responsible for the management of the limited partnership) may provide evidence of the purposes or intentions of a limited partnership.

Treatment applies only in the person's capacity as a partner

79. An intention or purpose that a partner is treated as having under s HG 2(1)(a) will not apply to the partner in relation to their non-partnership activities. For example, a partner of a land-dealing partnership is not treated as having the purpose of the partnership in relation to land that the partner owns in their separate capacity. Section HG 2(1) applies to partners only in their capacity as partners.

Exception relating to purpose or intention for partnership share

80. The Commissioner considers that a partner can hold a separate purpose or intention of disposal in relation to the partner's interest in partnership property by having a purpose or intention of disposing of some or all of their partnership share (that is, exiting or reducing their interest in the partnership).[38]
81. A disposal of partnership share involves the disposal of interests in partnership property. For example, a partner has a 25% partnership share in a partnership that owns land and other property. If the partner exited the partnership by selling their 25% partnership share to another partner, the partner would be disposing of their 25% interest in the land owned by the partnership (along with their 25% interest in the other partnership property).
82. A partner could have a purpose or intention of disposing of some or all of their partnership share. If they do, it follows that they also have a purpose or intention of disposing of their interest in any property owned by the partnership.
83. This is not inconsistent with s HG 2. Section HG 2 treats a partner as having a purpose or intention of the partnership; it does not preclude the partner from having other purposes or intentions.
84. Further, s HG 2 still applies. A partner with a separate purpose that arises in the way described in [82] would also be treated under s HG 2 as having the partnership's purpose or intention with respect to the property. Therefore, the partner could simultaneously hold a purpose or intention with respect to the disposal of their partnership share (which is also a purpose or intention of disposing of partnership property) and be treated as holding the partnership's purpose or intention to retain the property. Although this seems incongruous, it is possible because the purposes or intentions arise in different ways and relate to different ways that the interest in partnership property can be disposed of.
85. Importantly, the partnership purpose or intention does not override or prevent the partner from having the separate purpose or intention with respect to the disposal of the partnership share (which is also a purpose or intention of disposing of partnership property). This is simply because the partnership purpose or intention for the partnership property does not preclude a partner from having the purpose or intention with respect to the disposal of the partnership share.
86. The proposition discussed at [64] that, generally, a partner cannot hold a separate intention or purpose (in relation to the disposal of the property by the partnership), does not preclude a partner from holding a purpose or intention that arises in the way described in [82]. This is because the proposition discussed at [64] relies on the principle that a partner cannot deal with partnership property separately from the partners, ie without their agreement. A purpose or intention as described in [82], does not arise from any dealing in partnership property that would require the agreement of the other partners.
87. Unlike a purpose or intention involving a disposal of partnership property by the partners as a partnership, a partner can genuinely hold a separate purpose or intention of disposing of some or all of their partnership share and, therefore, genuinely hold a purpose or intention of disposing of their interest in the partnership property held via that share.
88. The approach outlined above does not involve viewing a partner's partnership share as separate property that when disposed of has its own tax consequences. That would be inconsistent with the transparency of partnerships. Rather, the interpretation is based on the fact that a disposal of partnership share is a disposal of a partner's interests in the partnership property.

38 Here, by partnership share, we mean the partner's partnership share generally, not their share in the particular partnership property.

89. In the context of a section such as s CB 6, a separate purpose or intention of disposal that arises in the way described in [82], could (if it is held when the interest in land is acquired) satisfy the requirement in that section to have an intention or purpose of disposal.

90. This is illustrated in Example | Tauira 4.

Example | Tauira 4 - Partner with purpose of disposing of partnerships share

Facts

Person 1 wished to purchase land for the purposes of a community housing development. Person 1's plan was to build houses on the land and rent them.

Person 1 needed funding to complete the purchase and begin development, so person 1 invited person 2 to invest in the early stages of the development through a limited partnership.

Person 2 was only interested in being involved in the project for two to three years. Persons 1 and 2 understood that after two to three years person 2 would seek to sell its partnership share either to person 1 or a new partner and provision was made for this in the partnership agreement.

Person 2 hoped that with the initial development work, the land would increase in value and, as a result, it would be able to sell its partnership share and make a good return on the funds it contributed to the partnership.

Persons 1 and 2 each contributed $4 million to the partnership and took 50% partnership shares.

The partnership used these contributions to acquire land for $7 million and started developing the land as planned using the other $1 million of capital contributions.

After two and half years, person 2 sold their partnership share for $5.5 million to person 1, who by that time had secured alternative funding. Of the $5.5 million paid for the partnership shares, $5 million was allocated to the value of the interest in land.

Tax treatment

For the partnership, the land is a capital asset as the business of the partnership will involve renting the houses that will be built on the land. The purpose or intention of the partnership with respect to the land is to use the land for rental purposes.

Section HG 2(1)(a) treats partners 1 and 2 as having this partnership purpose or intention.

However, at the same time, person 2 has a purpose or intention of selling its partnership share. When a partner disposes of partnership share, the partner is disposing of interests in partnership property. Therefore, person 2's purpose or intention of selling its partnership share is also a purpose or intention of selling its interest in the partnership land.

Person 2 had this purpose or intention when it acquired its interest in the partnership land. Therefore, person 2 has income of $5 million under s CB 6 from the disposal of its interest in the land. Person 2 also has a deduction of $3.5 million for its share of the cost of the land (50% of $7 million) and deductions for its share of development expenditure, which for person 2 would have been on revenue account.

Ownership of partnership property

91. A key concept of general law is that partners do not have individual rights in partnership property.[39] The interest a partner holds has been described as "a beneficial interest in the entirety of the partnership assets and in each and every particular asset of the partnership".[40] This is consistent with s 36(1) of the PLA, which states that partnership property must be held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement. No one partner can deal with any portion of the partnership property in their own interests.

39 This point has been made in several cases, including *Hadlee & Sydney Bridge Nominees Ltd v CIR* (1993) 15 NZTC 10,106 (PC), *CIR v Boanas* and *Crowe v C of T* (1958) 100 CLR 532 (HCA). It was also confirmed by P Webb and A Molloy in *Principles of the law of partnership* (6th ed, Butterworths, Wellington 1996).

40 *Hadlee* at 10,110.

92. For income tax purposes, a partner is treated as holding property that a partnership holds, in proportion to the partner's partnership share, and the partnership is treated as not holding the property. Among other things, this means income derived from partnership property (for example, royalties) is derived by the partners, not by the partnership.

Party to an arrangement

93. For the purposes of a partner's liabilities and obligations under the ITA in their capacity of partner of a partnership, a partner is treated as being party to an arrangement to which the partnership is a party.

94. "Arrangement" is defined in the ITA. It means an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect.[41] The term is used in various parts of the ITA.

95. Being treated as party to an arrangement means a partner may be treated as being party to, for example, a financial arrangement[42] or a tax avoidance arrangement[43] that a partnership is party to.

Actions and entitlements

96. For the purposes of a partner's liabilities and obligations under the ITA in their capacity as a partner in a partnership, a partner is treated as doing a thing and being entitled to a thing the partnership does or is entitled to.

97. An entitlement to a thing, includes an entitlement to an amount of income.

Alternative view that taxing provisions are applied at the partnership level

98. An alternative view, that taxing provisions are applied at the partnership level and amounts simply divided between partners, was considered.

99. The view that tax questions should be determined at the partnership level is inconsistent with the transparent tax treatment provided by s HG 2(1). The transparent tax treatments mean that generally, the "person" referred to in taxing provisions can only be the partner, not the partnership. See from [26].

100. Arguments made for the alternative view are based on:
    - The reference in s HG 2(2) to "partnership income".
    - The existence of section YB 12.
    - the discussion document General and limited partnerships – proposed tax changes.[44]

101. The reference in s HG 2(2) to "partnership income" is part of a larger phrase "partner's partnership share in the partnership's income". It is considered that in this context, "partnership's income" is being used to describe an aggregate amount, notwithstanding the transparency created by s HG 2(1). Therefore, the reference to this term is not inconsistent with tax provisions applying at the partner level.

102. Section YB 12 provides an associated person test for associating a person (normally a partner) with a partnership. It might be argued that association with a partnership is only needed if taxation questions were determined at the level of the partnership. However, this is not necessarily the case. Transparency of partnerships does not always apply. Where it does not apply, association with a partnership will be relevant and, therefore, s YB 12 will have application. For example, in a transaction where a taxing provision is being applied to a person who is not a partner or a partnership, but the other party to the transaction is a partnership, transparency does not apply. For that transaction, if association between the parties to the transaction was relevant, it would be necessary to test association with the partnership, not the partners of the partnership.

41 Section YA 1.

42 Under subpart EW.

43 Under s BG 1.

44 General and limited partnerships – proposed tax changes (discussion document, Policy Advice Division, Inland Revenue, June 2006) at [5.14].

103. When the current partnership rules were being designed, consideration was given to different approaches to the taxation of partnerships. In terms of the design of the tax system, partnerships could be taxed on an entity basis or on an aggregate basis or on a hybrid of the two. An aggregate approach involves transparency, and an entity approach does not.[45] The discussion document leading to the introduction of the new rules proposed an entity approach.[46] However, the approach that was ultimately enacted in the ITA is more closely aligned with an aggregate approach. This is clear from the treatments enacted in s HG 2(1). It is also supported by comments made in the officials' report on parts 5 and 6 of the Limited Partnerships Bill.[47] The report records a summary of submissions and the response to the submissions by officials. The officials stated:

> The proposals aim to codify the current tax treatment of partnerships, which is more closely aligned with the aggregate approach of treating each partner as the owner of a fraction of all the assets of the partnership for tax purposes. This partnership does not exist independently from the partners. The rules attempt to provide a reasonable balance between the integrity and accuracy of this flow-through mechanism provided by the aggregate approach, and the administrative and compliance convenience of the entity approach.

104. However, as discussed from [35], the approach is not purely an aggregate one and transparency does not always apply.

Attribution of amounts

Attribution based on a partner's partnership share in the partnership income – no streaming rule

105. For income tax purposes, partners cannot choose how much of an amount (of a particular nature or from a particular source) to attribute to each partner; attribution is automatic.

106. Under s HG 2(2), a partner is attributed a portion of the total amount that the partners have from a particular source or of a particular nature (the amount could be income, a tax credit, a rebate, a gain, expenditure, or a loss).

107. Section HG 2(2) is intended to prevent the streaming of an amount of income, tax credit, rebate, gain, expenditure, or loss of the partners from particular sources or of a particular nature.[48] For example, if a partnership attributed foreignsourced amounts to non-resident partners and New Zealandsourced amounts to New Zealand resident partners, s HG 2(2) would recharacterise the attribution for income tax purposes. All the partners would be treated as having a share in the foreignsourced and New Zealandsourced amounts based on the partners' partnership share in the partnership's income.

108. Despite the purpose of s HG 2(2) being to prevent streaming, the section applies generally – it is not necessary to establish that there is an arrangement with a purpose or intention of avoiding tax.

109. Under s HG 2(2) the attribution of amounts is calculated based on the partner's **partnership share in the partnership's income**. This is discussed further from [111].

110. The no streaming rule in s HG 2(2) is subject to three exclusions set out in s HG 2(4). The exclusions relate to a person entering a partnership where the safe harbour rules do not apply, supplementary dividends and imputation credits.

Identifying a partner's partnership share in partnership income

111. In s HG 2(2) it is necessary to identify a partner's partnership share in the partnership's income.

112. Although the term "partnership share" is defined in s YA 1,[49] s HG 2(2) specifically refers to the "partner's partnership share in the partnership's income".

45 Under an aggregate approach, the taxation of the partnership as a whole is reflected only in total, or in aggregate, from the tax treatment of each of the partners.

46 General and limited partnerships – proposed tax changes (discussion document, Policy Advice Division, Inland Revenue, June 2006) at [5.14].

47 Limited Partnerships Bill - officials' report on tax aspects of parts 5 and 6 of the bill (Policy Advice Division, Inland Revenue, November 2007) at 8.

48 This is reflected in the subsection heading "No streaming".

49 "Partnership share" is defined as meaning, for a particular right, obligation, or other property, status or thing, the share a partner has in the partnership. This definition means that a partner's partnership share can be different for different things.

113. A partner's partnership share in the partnership's income might be specified in a partnership agreement. If not, it will be necessary to determine the partner's partnership share in the partnership's income from other factors. In some cases, factors such as the partner's partnership share in different things[50] or the partners' capital contributions or voting interests could be relevant to the determination. If the partners' partnership shares are not specified in a partnership agreement, a general presumption, at least for general partnerships, is that partners have equal partnership shares.[51]

114. Records should be kept of any changes in the partners' partnership shares in the partnership income as these may be required as evidence to support a change in the attribution of amounts to partners for income tax purposes. It is understood that some partnerships have earn-in arrangements for new partners under which the partner's partnership share in the partnership's income increases year by year.

115. A partner could have different partnership shares in different partnership income sources or income of a different nature. If so, the partner's partnership share in the partnership's income is their overall share.[52] If the partner's share in one income source or nature changes (for example, in the case of earn-in arrangements for new partners), it will be necessary to recalculate the partner's partnership share in the partnership's income.

116. The calculation of a partner's partnership share in the partnership's income, and the attribution of amounts from different sources or of a different nature, is illustrated in Example | Tauira 5 and Example | Tauira 6.

Example | Tauira 5 - Attribution of amounts under s HG 2(2), simple example

A partnership owns company shares and has a debt owed to it.

The partnership agreement provides that partner 1 has a 90% partnership share of dividends derived from the company shares and a 10% partnership share of the interest derived from the debt owed to the partnership.

In the 2025 income year, the partnership's only income was $100 of dividends from the shares and $100 of interest from the debt.

Under the partnership agreement partner 1 has an entitlement to $90 of the dividends and $10 of the interest. In total, partner 1 has a share of $100 of income out of the total $200 of income derived by the partnership.

This means that partner 1 has a partnership share in the partnership's income of 50% for the 2025 income year.

Under s HG 2(2), partner 1's 50% partnership share in the partnership's income is used to determine how much dividend and interest income the partner is treated as having for income tax purposes. Partner 1 is treated as having $50 of dividend income and $50 of interest income.

Example | Tauira 6 – Attribution of amounts under s HG 2(2), detailed example

Facts

Professional Services Partnership recently appointed a new partner, partner 10. Under the partnership agreement, partner 10 has a 10% partnership share in partnership property and of any income derived from the partnership property, including rent derived from the sublease of office space and interest derived on investments.

However, partner 10's share of the partnership's business income in their first year as partner is subject to performance.

Partner 10's performance in their first year entitles them to a 6% share in the partnership's business income.

For the first year, Professional Services Partnership has the following amounts:

Business income	$800,000
Business expenditure	$400,000
Rental income	$50,000
Income from investments	$24,000
Tax credits (33% of the income from investments)	$7,920

50 The definition of "partnership share" share in s YA 1 could be relevant to this extent.

51 Under s 45 of the PLA. There is no equivalent provision in the LPA.

52 This is supported by the purpose of s HG 2(2) being to prevent streaming. If a partner could, for the purposes of s HG 2(2), have different partnership shares in different sources of income or income of different natures, the purpose to prevent streaming could not be achieved.

Professional Services Partnership has total income of $874,000 ($800,000 + $50,000 + $24,000). Partner 10 has rights to 6% of the business income ($48,000) and 10% of the rental income and income from investments ($5,000 and $2,400), which totals $55,400. Overall, Partner 10 has a 6.34% (weighted average) share of the partnership's total income.

Tax treatment

Section HG 2(2) requires that the income, expenditure and tax credit be attributed to the partners based on each partner's partnership share in the partnership's income. To do this it is necessary to determine the partner's partnership share in the partnership's income. In this example, the appropriate approach is to use the weighted average of 6.34% (as calculated above) to attribute all the income, expenditure and tax credits.

The effect of s HG 2(2) on the amounts attributed to partner 10 for tax purposes is summarised in the following table:

Source or nature of amount	**Partnership total**	**Partner's share**	**Without s HG 2(2)**	**With s HG 2(2)** (using 6.34% weighted average)
Business income	800,000.00	6%	48,000.00	50,709.38
Rental income	50,000.00	10%	5,000.00	3,169.34
Income from investments	24,000.00	10%	2,400.00	1,521.28
Total income	874,000.00		55,400.00	55,400.00
Business expenditure	400,000.00	6%	24,000.00	25,354.69
Net income	474,000.00		31,400.00	30,045.31
Tax credit	7,920.00	10%	792.00	502.02

117. For the attribution of income and other amounts when there has been a change in partners or partnership share, see [214].

Deductions

118. Expenditure incurred by the partnership is the total of all expenditure amounts incurred by the partners in their capacity as partners. This total amount is attributed between the partners in proportion to the partners' partnership shares in the partnership's income. It does not matter who was responsible for incurring the amounts; all partners share in the expenditure according to their partnership share in the partnership's income.

119. The deductibility of expenditure by a partner is subject to the usual rules for deductibility. For example, a partner may be able to deduct a portion of the expenditure of the partnership (which they are treated by virtue of s HG 2 as incurring) if the expenditure was incurred in the course of carrying on the business of the partnership (which a partner is treated under s HG 2 as carrying on) and none of the general limitations apply.

120. In the case of limited partnerships, a limit exists on the amount of deductions a limited partner can claim in an income year as a partner of a limited partnership. This is called the deduction limitation rule. This is discussed from [399].

Anti-avoidance provisions

121. The anti-avoidance provision in s GB 23 gives the Commissioner the ability, in specified cases, to reallocate income and deductions as the Commissioner considers reasonable.

122. One of the specified cases is where a partnership employs or engages a relative of a partner,[53] and the Commissioner considers the income payable to the relative for the services they provide is excessive.[54]

53 Or, in the case of a company, a relative of a director or shareholder in the company.

54 Section GB 23(2).

123. Another case is where a partner in a partnership is a relative of another partner,[55] and the Commissioner considers the other partner's share of the partnership's income and deductions is excessive.[56]

124. In applying s GB 23, the Commissioner can take into account:

- the nature and extent of the services rendered by the relative;
- the value of the contributions made by the respective partners, by way of services, capital, or otherwise; and
- any other relevant matters.

125. Section GB 23 does not apply if there is a "genuine" partnership contract. Section GB 24(2) outlines eight situations in which a contract is treated as genuine.

126. Further discussion of this topic is in **QB 14/09: Income tax – meaning of "excessive remuneration" and "excessive profits or losses" paid or allocated to relatives, partners, shareholders or directors**,[57] which explains the meaning of "relative", "excessive remuneration", "excessive profits or losses", and when a contract is treated as genuine.

127. Another anti-avoidance provision that supports the partnership rules is s GB 50. Section GB 50 applies if:

- a partner enters into an arrangement;
- the arrangement involves a non-market value amount of consideration; and
- the arrangement has a purpose or effect of defeating the intent and application of subpart HG.

128. Where it applies, a market value amount of consideration is substituted for the consideration under the arrangement.

Joint return of income

129. Although there is no joint assessment of income, for most partnerships, partners are required to file a joint return of income. This applies to:[58]

- The partners of a limited partnership if the limited partnership is registered under the LPA.[59] This applies whether or not the limited partnership carries on business in New Zealand and whether or not any of the partners (limited or general partners) are resident in New Zealand.[60]
- The partners of a general partnership if the partnership carries on a business in New Zealand.[61]

130. Joint venturers or co-owners of property can choose to be treated as a partnership.[62] The Commissioner will treat joint venturers or co-owners of property as having made this choice if they file a joint return of income as if they were a partnership.

131. The joint return of income must include:

- the total amount of income derived by the partners as members of the partnership;
- the partners' partnership shares in the income; and
- a summary of the deductions of each partner.

132. The joint return can be completed online or using Inland Revenue forms IR7 and IR7P. The IR7 records the income and deductible expenditure of the partnership and the IR7P shows how the income and deductible expenditure is attributed to each partner.

55 Or, in the case of one or more of the partners being a company, the relationship can be with a relative of a director or shareholder in the company.
56 Section GB 23(3).
57 *Tax Information Bulletin* Vol 26, No 9 (October 2014): 22.
58 Section 42 of the TAA.
59 The requirement for the limited partnership to be registered under the LPA means that this joint return requirement does not apply to an "overseas limited partnership", despite an overseas limited partnership being included in the definition of "limited partnership" for income tax purposes.
60 Although a general partner might not be resident, there must be a general partner that satisfies the requirement of s 8(4). See [10].
61 Ignoring for a moment the transparent treatment of partnerships under s HG 2, under which a partnership is treated as not carrying on an activity.
62 See definition of "partner" in s YA 1.

133. In some cases, there may be insufficient room on the IR7P (if using the manual form rather than MyIR) or it may be impracticable to enter information separately for a large number of partners. In such cases, you can provide the information required by the form in a separate document, provided you notify the Commissioner you are doing this and the document contains all the information required by the form. The Commissioner also has a specific power to approve the provision of return information by electronic means.[63]

134. It is important to include each partner's IRD number, as prescribed by the Commissioner in the IR7P (as well as the partnership's own IRD number). Section 35 of the Tax Administration Act 1994 (TAA) gives the Commissioner the power to prescribe forms for income tax purposes, including for the purpose of partners providing a joint return of partnership income. Further, s 53(2) of the Legislation Act 2019 gives the Commissioner the power to identify information to be supplied. In the Commissioner's view, these powers give the Commissioner authority to require all partners' IRD numbers be included in the return. Requiring such information is also consistent with the purpose of the ITA to assess each partner based on each partner's share of the partnership income and deductions.

135. Despite partners being required to file a joint return, income is not jointly assessed. Instead, each partner's income is assessed separately.

Separate return of income

136. To facilitate the separate assessment, each partner must make a separate return of income, including the income they derive as a member of the partnership and their deductions.[64] Because it results in an assessment, the correctness of the separate return of income is particularly important.

137. When preparing their separate returns, partners cannot necessarily rely on the amounts included in the joint return. The amounts included in the joint return may not always be correct. As noted above, in practice, the Commissioner understands that in some cases, it might be impractical in the joint return for the partners to accurately take into account the effect that a partner's individual circumstances can have on their income and deductions.

138. If a partner uses amounts included in the joint return as a starting point for their separate return, adjustments may be needed to ensure the correctness of the amounts returned. For example, under the financial arrangement rules, a partner might be a cash basis person and so might have a different tax treatment for a financial arrangement than the other partners (and what might have been presented in the joint return of income).

139. Being a partner of a partnership triggers an obligation under s 33 of the TAA to file an income tax return each year (if the partner is not already required to file a return).[65]

140. An exception to the requirement to file a separate return applies for a non-resident partner of a partnership where the partner:[66]
    - does not derive income from any source in New Zealand (this requires that none of the partners derive income in their capacity as partners from any source in New Zealand – this is because of s HG 2(2) (No streaming)); or
    - derives only non-resident passive income to which s RF 2(3) and (4) applies – where tax is withheld as a final tax; or
    - derives only income from a source in New Zealand that is fully relieved from tax under a double tax agreement.

141. Even if a partner is not required to file a separate return, the partners (as a partnership) are still required to file the joint partnership return of income for New Zealand tax administration purposes, even if the assessable income is nil. This is for the purposes of determining any international obligations New Zealand may have concerning the partnership.

142. A partner to whom the joint return obligation does not apply (for example, a partner of an overseas limited partnership) must nevertheless include their share of the joint income and deductions in a separate return of income.

63 Section 36 of the TAA.

64 In an IR3 if the partner is a natural person, in an IR4 if the partner is a company, or in an IR6 if the partner is the trustee of a trust.

65 This is required by s 42(3)(b) of the TAA. Section 33 of the TAA requires a person to file a return of income for a tax year in the form and with the particulars the Commissioner prescribes. In the case of a limited partnership that derives only foreign-sourced income, the non-resident partners may not have any assessable income, so may not be required to file an individual income tax return for their partnership income. However, the partners are still required to file a joint partnership return of income, even if the assessable income is nil. This is for the purposes of international obligations New Zealand may have concerning the partnership.

66 Section 42(3)(d).

143. If a partner is an "absentee partner" then a partner of a general partnership or a general partner of a limited partnership may have an obligation, as agent, to file the absentee partner's separate return of income and satisfy any income tax liability for the absentee partner. Liability for absentee partners is discussed further from [327].

Non-standard balance dates

144. If the partnership has a non-standard balance date, a partner may choose to return the income and deductions that they have in their capacity as a partner of the partnership – calculated based on the partnership's balance date – in the partner's separate return for the corresponding tax year.[67]

145. In other words, a partner may make a return of the partnership income and deductions as if they also had the partnership's non-standard balance date for that source of income. A partner does not have to reallocate the income and deductions based on when the income was derived, or expenditure was incurred, relative to a tax year.

146. By choosing to return income in this way, a partner is making an election to continue returning in this way in subsequent income years, and this election is irrevocable while the partner remains a member of the partnership, unless the partnership changes its balance date.[68]

147. A partner should continue to return income from other sources calculated based on the tax year ended 31 March or based on another relevant non-standard balance date (if, for example, the partner has a non-standard balance date for another business).

148. If a partner exits the partnership part way through the partnership's income year, the income tax position may need to be determined for the partner for the part of the partnership income year the person was a partner (the attribution of amounts where there is a change in partners is discussed further at [214]). If so, only the part-year position would be included in the partner's income tax return.

149. This is illustrated in Example | Tauira 7.

Example | Tauira 7 - Partnership with non-standard balance date

Facts

A farmer carries on a sheep farming business. He is also a partner in Honey Partnership, which carries on a bee-keeping business.

The farmer elected to have a non-standard 30 June balance date for the sheep farming business. The partners of Honey partnership elected to have a non-standard balance date of 31 December. The Commissioner consented to both elections.

For the 2023 tax year (ending 31 March), the farmer has the following income:

- income from the sheep-farming business of $200,000 for the year ended 30 June 2023;
- income derived as a partner of Honey partnership of $50,000 for the year ended 31 December 2022; and
- dividends of $4,000 from investments for the tax year ended 31 March 2023.

67 Section 42(3)(c). A "tax year" is always a period ended 31 March. Income years can end on 31 March or end with a non-standard balance date. An income year with a non-standard balance date will always correspond to a specific tax year. A non-standard balance date on or before 31 October in a calendar year will correspond to the tax year ended 31 March in the same calendar year. A non-standard balance date ending after 31 October in a calendar year will correspond to the tax year ended 31 March in the following calendar year. The partner can include the partnership income in their return for the tax year that the partnership's income year corresponds to.

68 Section 42(3)(c).

Tax treatment

The 30 June 2023 balance date for the sheep farming business and the 31 December 2022 balance date for the Honey partnership both correspond to the 2023 tax year (the year ended 31 March 2023).

In the farmer's income tax return for the 2023 tax year, the farmer may return the $200,000 of income from the sheep-farming business (calculated to 30 June 2023), the $50,000 share of income from the Honey Partnership (calculated to 31 December 2022) and the $4,000 of dividends. This would give the farmer an annual gross income for 2023 of $254,000.

Even though the year ended 31 December 2022 crosses over the 2022 and 2023 tax years (ending 31 March), all $50,000 of the partnership income is included in the return for the 2023 tax year. No reallocation of this amount is required between the tax years in which the $50,000 was derived.

Transactions between a partnership and a partner

150. The Commissioner's view is there is a full (rather than a partial) disposal of property in the following situations:
    - A person transfers property to a partnership of which they are a partner.
    - A partnership transfers property to a partner of the partnership.

151. In these situations, it might be argued that because of s HG 2, a partner is treated as holding the property, or at least part of the property based on the partner's partnership share, before and after the transfer, so there is no disposal of the property, or the relevant part.

152. The Commissioner's view is that s HG 2 does not apply in this context. This is because:
    - Section HG 2 applies for the purposes of a partner's liabilities and obligations under the ITA **in their capacity as partner**. A person who is a partner of a partnership can act in two capacities: in their capacity as a partner of the partnership and in their separate non-partnership capacity.
    - Section HG 2 only applies if the context does not require otherwise. Legal fictions such as those created by s HG 2 are only meant to be taken as far as is necessary to achieve the purposes of the provision. The Commissioner's view is that s HG 2 was not intended to invite a conclusion that there is no disposal because the same interests in property are held before and after the transfer.
    - From a non-tax perspective, in these situations an interest in property held by a person before the transfer will differ from the interest in the property held afterwards because of the nature of partnerships and the interests in partnership property held by partners.

153. An example of a transfer between a partner and a partnership is a capital contribution made by a person on joining a partnership or acquiring additional partnership share. This is considered in **QB 17/09: Is there a full or partial disposal when an asset is contributed to a partnership as a capital contribution?**[69]

154. The view expressed at [152] is consistent with QB 17/09 but goes further. In comparison with QB 17/09, the view expressed at [152] is more general, applies to transactions in either direction (from a partner to a partnership or from a partnership to a partner) and is based on additional reasoning (s HG 2 only applies if the context does not require otherwise).

69 *Tax Information Bulletin* Vol 30, No 1 (February 2018): 10.

Loan from a partner to a partnership

155. With respect to a loan made by a partner to a partnership:
    - The loan is made by the partner in their non-partner capacity.
    - The full amounts of loan principal and other loan payments (rather than partial amounts) are transferred between the partner and the partnership.
    - The partner could have income and deductions in relation to the loan in their non-partner lender capacity and income and deductions in relation to the loan in their partner borrower capacity.
    - The transparency of partnerships under s HG 2 generally applies for the purposes of the financial arrangement rules. For example, one of the partners of a partnership may be a cash basis person and not be required to apply a spreading method. In determining whether the partner is a cash basis person, the relevant thresholds are calculated with reference to the amounts that the partner is treated as having in their capacity as partner under the partnership (by virtue of s HG 2) and amounts that they have in their non-partner capacity.[70]
    - If a loan amount is remitted, in some cases a portion of the loan amount remitted may be treated as having been repaid.[71] This will reduce the debt remission income for the partnership.
    - In their base price adjustment calculation, the partner, as lender, will have an "amount remitted" that is reduced by the "self-remission" amount, being the amount of the debt remitted that the partner was liable for as debtor by virtue of s HG 2.[72]
156. The resident withholding tax (RWT) and non-resident withholding tax (NRWT) obligations of a partnership that pays interest to a lender are discussed from [236]. The type of withholding required by the partnership will depend on the residency of the lender partner.
157. Also note that in the deduction limitation rule (discussed from [399]), a loan made by a limited partner to a limited partnership is included in the definition of "capital contribution".

Changes in partners

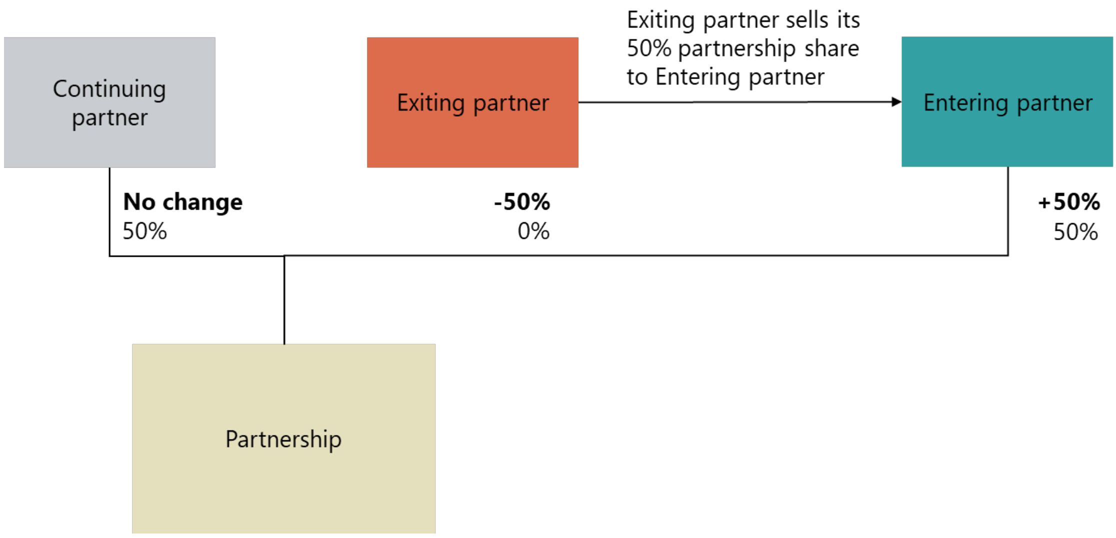
158. When a new person joins a partnership or an existing partner increases their partnership share (in either case, the person is referred to as an entering partner), they take partnership share from one or more of the existing partners (these partners are referred to as exiting partners, whether they are giving up all or part their partnership share).
159. An entering partner, when they join a partnership, may take partnership share from any number of partners.
160. For example, in a partnership consisting of two existing partners with equal partnership shares, an entering partner may acquire the partnership share of one of the existing partners. In this case, the entering partner takes the place of the exiting partner. The continuing partner's partnership share is unaffected. This is illustrated in Diagram | Hoahoa 2.

70 See IS 22/05: Cash basis persons under the financial arrangements rules for information generally on when a person can account for income and expenditure from financial arrangements on a cash basis instead of an accrual basis.

71 Section EW 46C. See Debt remission and associated amendments, Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017 *Tax Information Bulletin* Vol 29, No 5 (June 2017).

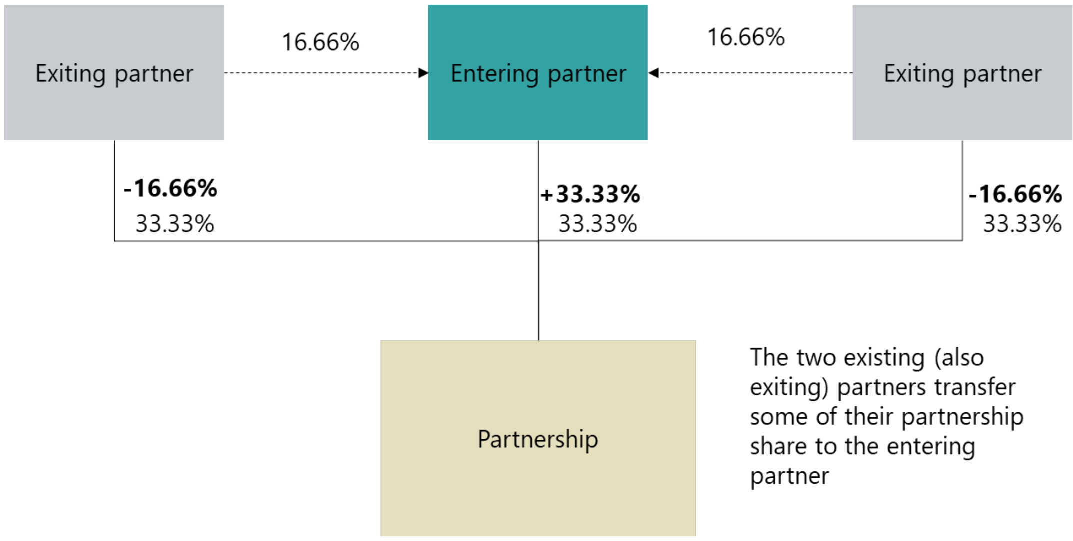
72 Section EW 31(11) (base price adjustment) and definition of "self-remission" in s YA 1.

Diagram | Hoahoa 2 - Continuing partner no change in partnership share



161. Another example is where, in a partnership consisting of two existing partners with equal partnership shares, an entering partner joins the partnership, adding a third partner and giving each partner a one-third partnership share.[73] In this case, the two existing partners' partnership shares are both reduced. This is illustrated in Diagram | Hoahoa 3.

Diagram | Hoahoa 3 - Change in partnership shares



162. An entering partner can provide consideration for the acquisition of partnership shares by paying amounts to the exiting partners or by introducing new property to the partnership, in which the other partners will obtain an interest.

163. If introducing new property, the value of the new property may be such that the total value of the property in which the existing partners have an interest remains the same. Despite this, if an existing partner gives up some of their partnership share, they are treated as disposing of an interest in the existing partnership property, while acquiring an interest in the new property added by the entering partner.[74] This is because a partner's interest in any partnership property is determined by their partnership share.[75] If a partner's partnership share changes, their interest in the partnership property also changes. This is illustrated in Table | Tūtohi 1.

73 The partnership shares of each partner do not necessarily need to be equal. Partners can agree to have unequal shares. However, in the absence of any agreement, it is assumed partnership shares are equal.

74 This is also discussed in **QB 14/02 Income tax – entry of a new partner into a partnership – effect on continuing partners** *Tax Information Bulletin* Vol 26, No 5 (June 2014): 53.

75 Under s HG 2, a partner is treated as holding property that a partnership holds, in proportion to the partner's partnership share.

Table | Tūtohi 1 – New property introduced to partnership

Before capital contribution				
	Partnership share	*Existing property*		*Total value of property*
Partner 1	50%	$60		$60
Partner 2	50%	$60		$60
Total		$120		$120
After capital contribution by partner 3 of $60				
	Partnership share	*Existing property*	*New property contributed by partner 3*	*Total value of property*
Partner 1	33.33%	$40	$20	$60
Partner 2	33.33%	$40	$20	$60
Partner 3	33.33%	$40	$20	$60
Total		$120	$60	$180

164. In Table | Tūtohi 1, Partners 1 and 2 have each disposed of an interest in the existing partnership property valued at $20. If the property was held on revenue account, Partners 1 and 2 could each have $20 of income from the disposal.[76]

165. Where an entering partner contributes property to a partnership, the partner is treated as making a full disposal of the property, despite the partner, after the disposal, having an interest in the property as a partner.

Purchase price allocation rules

166. Where a partner (exiting partner) disposes of some or all of their partnership share, they are disposing of interests in partnership property.

167. The purchase price allocation rules in s GC 20 and GC 21 may apply to determine how the amount paid for the partnership interests is allocated between the different interests in partnership property. These rules should be considered when there is a change in partners or partnership share.

168. The application of the purchase price allocation rules is beyond the scope of this statement. For more information on these rules, see **Setting up an asset sale (ird.govt.nz)** and the **Special report** on the Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Act 2021.[77]

Disposal of partnership property on change of partners

169. Under general law, a change in partners can mean a dissolution of the partnership, which would mean a disposal by all partners of all their interests in partnership property. However, this result is modified for income tax purposes.

170. The definition of "dispose" in the ITA departs from the general law position. For tax purposes, for a partner (like the continuing partner in Diagram | Hoahoa 2), a disposal does not occur merely because **another partner** disposes of that partner's interests.[78] This means, for income tax purposes, a partner whose partnership share is not reduced when a new partner joins the partnership (but other partners' partnership shares are reduced) does not dispose of any interest in partnership property.

171. The position is different on a final dissolution of a partnership where the business of the partnership will not continue to be carried on in partnership.

76 Unless the safe harbour rule in s HG 5 applies.

77 Special report on the Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Act 2021 (Policy and Regulatory Stewardship, Inland Revenue, 28 April 2021): 33.

78 Paragraph (h)(i) of the definition of "dispose" in s YA 1.

Death of a partner

Partnership can continue after the death of a partner

172. Under general law, for a general partnership, the death of a partner will trigger the dissolution of a partnership, unless an agreement between the partners provides otherwise.[79]

173. Notwithstanding the position under the general law, for tax purposes, a general partnership can continue for the surviving partners, provided that there are still at least two partners.[80] A general partnership must have two or more partners.[81]

174. Where a general partnership consists of two partners and one partner dies, the Commissioner may treat the partnership as continuing provided the business continues and the administrator or executor of the deceased's estate transfers, within a reasonable period, the partnership interests of the deceased partner to a new partner or partners. It will be question of fact and degree whether there is a change in partners or a new partnership.

175. The death of a general partner or limited partner of a limited partnership will not cause the partnership to be dissolved, provided at least one general partner and one limited partner remain. A limited partnership must have at least one general partner and at least one limited partner. If a partner dies and there is no general partner or no limited partner for 10 working days, this could be a "terminating event" under s 86 of the LPA (this 10 working-day period can be extended). A terminating event could lead to the liquidation and deregistration of a limited partnership.[82] This would be a final dissolution for the purposes of s HG 4. A final dissolution would trigger deemed disposals of a partner's interests in the partnership, which could result in income and other tax implications.

Disposal of partnership interests

176. For income tax purposes, on the death of a partner, there is a disposal of the deceased's partnership interests to the administrator or executor of the deceased's estate immediately before the person's death.[83]

177. The asset transfer rules in subpart FC apply to a disposal of partnership interests on the death of a partner and to any subsequent distribution of those interests by the administrator or executor of the deceased's estate.[84]

178. Under the asset transfer rules, the transfer from the deceased to the administrator or executor is treated as being made at market value and as occurring immediately before the person's death. If the partnership interests include an interest in revenue account property, for example, this could lead to an income tax liability.

179. An exception may apply if the partnership interests are transferred to the surviving spouse, civil union partner, or de facto partner of the deceased person. Where the requirements of this exception are met, the transfer of the property (including any intervening transfer to an executor or administrator) can instead be treated as a settlement of relationship property under subpart FB. This may prevent an income tax liability arising on the transfer of the property.

180. The asset transfer rules are discussed in **Death and asset transfers**.[85]

Safe harbour rules

181. Where an exiting partner is treated as disposing of property under the ITA, the safe harbour rules may apply to alter the tax effect of the disposal for the exiting and entering partners.

79 Section 69 of the Partnership Law Act.

80 This is supported by s HG 4 (Disposal upon final dissolution). The circumstances in which s HG 4 applies do not exactly match the circumstances of a dissolution for non-tax purposes. For s HG 4 to apply, s HG 4 also requires that the partnership's business will not continue to be carried on in partnership. This additional requirement implies that, for tax purposes, the partnership can continue despite an event that, under general law, could result in the final dissolution of the partnership.

81 A general partnership is defined as the relationship that exists between persons carrying on a business in common with a view to profit.

82 See ss 86 to 92, 92A and 93 to 99 of the LPA.

83 Sections FC 1(1)(a) and FC 2(2).

84 The Commissioner's view is that because the asset transfer rules in subpart FC cater for a specific type of disposal (death), the rules in subpart FC apply instead of partnership safe harbour rules (if those rules could apply).

85 *Tax Information Bulletin* Vol 17, No 7 (September 2005): 42.

182. Essentially, if certain requirements are satisfied, where partners change, the safe harbour rules allow an entering partner to step into the shoes of an exiting partner,[86] with the disposal being ignored for tax purposes. The entering partner takes on the cost base of the exiting partner, so on a subsequent disposal the entering partner may have a tax liability similar to what the exiting partner would have had if they had not disposed of their partnership interest to the entering partner.

183. Section HG 5 provides a general safe harbour rule that can apply to the whole of the partnership interest that is disposed of. If s HG 5 does not apply, ss HG 6 to HG 10 provide safe harbour rules that may apply to the disposal of specific types of partnership interest.

Safe harbour rules do not apply on final dissolution

184. The safe harbour rules in ss HG 5 to HG 10 do not apply if the partnership is finally dissolved, **and** the partnership's business will "not continue to be carried on in partnership".[87] The partnership's business will "not continue to be carried on in partnership" if the business ceases, or if the business is carried on but by only one person, for example.

185. The tax treatment on the final dissolution of a partnership is discussed further at [217].

Small partnerships

186. The partners of a small partnership can elect not to apply the safe harbour rules in ss HG 5 to HG 9. To do this the entering partner, exiting partner, and partnership simply need to file returns of income that ignore the sections.

187. A "small partnership" is a partnership that is not a limited partnership, and that has five or fewer partners that are not companies or partnerships themselves.

General de minimis rule – s HG 5

188. Section HG 5 applies where:

- an exiting partner disposes of some or all of their partnership interests to an entering partner; and
- the amount calculated using the formula in s HG 5(1) is less than zero.

189. The formula in s HG 5(1) is as follows:

> disposal payment + previous payments − (gross tax value − liabilities) − $50,000.

190. The formula in s HG 5(1) examines whether the amounts paid or payable to the exiting partner (including the consideration for the current interests and any consideration for other disposals of their partner's interests that have occurred in the year before the disposal) exceed the difference between the "gross tax value" and liabilities by more than $50,000. If the amount paid to the exiting partner is higher than a certain amount, as measured by this formula, s HG 5(1) does not apply.

191. In the formula, "disposal payment" is the total amount of consideration paid or payable to the exiting partner for the current interests.[88] In some situations, an entering partner will agree to make a capital contribution to the partnership as consideration for some of the current interests of the exiting partner (which the exiting partner will benefit from through their remaining partnership interests). In such cases, the value of the capital contribution is part of the total amount of consideration paid or payable and, therefore, is included in the "disposal payment" amount in the formula.

192. In the formula, "gross tax value" is the total value of the interests disposed of. For the purposes of determining the gross tax value amount:

- interests that are revenue account property or depreciable property have the value given to them by the ITA:
  - revenue account property will have its cost value; and
  - depreciable property will have its adjusted tax value;
- other interests have their market value, for example land held on capital account and financial arrangements.

86 The entering partner could be an existing partner who is acquiring further partnership interests from other partners. Similarly, an exiting partner may be disposing of only some of their partnership interests.

87 Section HG 3(1).

88 Section HG 5(2)(a).

193. The effect of s HG 5 applying for an exiting partner is as follows:
- The total amount of consideration paid or payable to an exiting partner for their partnership interests is treated as excluded income of the exiting partner.
- No deduction is allowed in relation to the partnership interests to the extent the entering partner is allowed a deduction. This is related to the entering and exiting partners being able to choose whether the exiting or entering partner will claim deductions for some or all the expenditure or loss incurred in the income year of the transfer under s HG 2(3). See [214].

194. The effect of s HG 5 applying for an entering partner is as follows:
- No deduction is allowed for the consideration paid or payable for the interest in the partnership.
- The entering partner is treated as if they had originally acquired and held the interests, not the exiting partner. This applies only for the purposes of calculating the income and deductions of an entering partner for the part of the income year after the disposal of the interests occurs and later income years.

195. This means the entering partner takes on the cost base and acquisition date of the exiting partner for the partnership interests acquired. It also means that the entering partner is treated as having the purposes or intentions of the partnership that applied when the exiting partner acquired the partnership interest.

196. The application of s HG 5 is illustrated in Example | Tauira 8, firstly where s HG 5 does not apply and then, in the variation, where it does apply.

197. The application of s HG 5 in the context of the land rules is discussed at [364].

Example | Tauira 8 – Safe harbour – general de minimis rule – s HG 5

Facts

Limited partnership A has two limited partners, partner 1 and partner 2 with equal partnership shares.[89]

Limited partnership A owns land on revenue account that was originally acquired for $500,000.

Partner 2 sells their partnership interests to a new partner, partner 3, for $300,000. The land has a market value of $1 million when partner 2 sells their partnership interest to partner 3. There is no change in the Partnership's purpose in holding the land.

No item of depreciable property held by the partnership cost more than $200,000.

At the time of sale, limited partnership A had assets and liabilities of:

• land held on revenue account (at cost, market value is $1 million)	$500,000
• depreciable property (adjusted tax value)	$100,000
• liabilities (generally accepted accounting practice)	$500,000

The $300,000 paid by partner 3 to partner 2 includes a payment of $500,000 for partner 2's interest in the land (being the market value of partner 2's interest), a payment of $50,000 for partner 2's interest in the depreciable property, less $250,000 for taking on partner 2's share of the partnership liabilities ($500,000 + $50,000 - $250,000 = $300,000).

INTERPRETATION STATEMENTS

89 Limited partnerships must have at least one general partner. However, for simplicity, examples in this statement do not refer to a general partner unless a general partner is relevant to the example. General partners normally do not have any partnership share, so generally their existence does not affect calculations in the examples.

Tax treatment

When the formula in s HG 5 is applied, the result is greater than zero, so s HG 5 does not apply:

amount paid for the interest - (gross tax value - liabilities) - $50,000

$300,000 – ($300,000[90] - $250,000[91]) - $50,000 = $200,000

However, s HG 7 does apply to limited partnership A's depreciable property.

Partner 2 has $500,000 of income for the disposal of the interest in the land (that was held on revenue account). Partner 2 can claim a deduction of $250,000 (partner 2's share of the cost) for this interest in land, so they have a taxable gain of $250,000 from the disposal.

Partner 3's cost base for the partnership interests they acquired is based on the amount they paid for the assignment of the assets. The question of how a global purchase price is allocated to particular assets is a separate topic outside the scope of this statement.[92] However, for the purposes of this example, it is assumed:

- $500,000 is paid for the land ($1 million ÷ 2);
- $50,000 ($100,000 ÷ 2) is paid for the depreciable property; and
- the purchase price is reduced by $250,000 for the liabilities ($500,000 ÷ 2).

This reconciles with the purchase price: $500,000 + $50,000 - $250,000 = $300,000.

Partner 3's cost base in relation to the partnership interest will be:

- land held on revenue account of $500,000; and
- depreciable property of $50,000

Partner 1's cost base is unaffected by the change in partner. Their cost base is:

- land held on revenue account of $250,000; and
- depreciable property of $50,000.

If the land was subsequently sold for $1 million:

- partner 1 would have a taxable gain of $250,000 ($500,000 $250,000 = $250,000); and
- partner 3 will not have any gain ($500,000 $500,000 = 0).

90 Partner 2's half share of the value of the land and depreciable property: ($500,000 + $100,000) ÷ 2 = $300,000.

91 Partner 2's half share of the liabilities: $500,000 ÷ 2 = $250,000.

92 Guidance on purchase price allocation rules is provided in *Tax Information Bulletin* Vol 33, No 6 (July 2021): 28.

Variation where s HG 5 applies

This variation has the same facts as given above, except the land cost $920,000.

Tax treatment

When the formula in s HG 5 is applied, the result is less than zero, so s HG 5 applies:

amount paid for the interest – (gross tax value – liabilities) - $50,000

$300,000 – ($510,000[93] - $250,000[94]) - $50,000 = -$10,000

The amount received by partner 2 (the exiting partner) for the partnership interest is treated as excluded income. They will not have any taxable gain on the disposal of assets.

Partner 3 (the entering partner) is treated as if they, not partner 2, had originally acquired and held the partnership interests. This means partner 3 takes on the cost base of partner 2 for the partnership interests acquired.

Partner 3's cost base in relation to the partnership interest is:

- land held on revenue account of $460,000 ($920,000 ÷ 2); and
- depreciable property of $50,000

Partner 1's cost base is unaffected by the change in partner.

If the land was subsequently sold for $1 million, partner 1 and partner 3 would each have a taxable gain of $40,000 ($500,000 - $460,000 = $40,000).

Trading stock that is not livestock – s HG 6

198. Section HG 6 applies to the disposal of trading stock that is not livestock. It applies only if for the income year of disposal, the total turnover of the partnership is $3 million or less.

199. The effect of s HG 6 applying for an exiting partner is as follows:
- The consideration received for the trading stock is excluded income.
- No deduction is allowed in relation to the trading stock for the income year to the extent to which the entering partner is allowed a deduction because of s HG 6(5).

200. The effect of s HG 6 applying for an entering partner is as follows:
- No deduction is allowed for the consideration paid or payable to the exiting partner for the trading stock.
- The entering partner is treated as if they had acquired and held the trading stock, not the exiting partner (s HG 6(5)). This means the entering partner takes on the cost base of the exiting partner for the trading stock. This applies only for the purposes of calculating the income tax liability of the entering partner.

Depreciable property – s HG 7

201. Section HG 7 applies to the extent to which an exiting partner disposes of depreciable property that is not depreciable intangible property to an entering partner. Section HG 7 applies if the total cost of the item when it was first acquired by the partners of the partnership is $200,000 or less.

202. The treatment for the exiting partner and the entering partner follows the same pattern as for trading stock.

Financial arrangements and certain excepted financial arrangements – s HG 8

203. Section HG 8 applies to the extent to which an exiting partner disposes of a financial arrangement or an excepted financial arrangement described in s EW 5(10) (an interest free, repayable on demand loan in New Zealand currency - excepted for the lender only). It applies only if the purpose for which the arrangement was entered into was necessary and incidental to the business of the partnership and the partnership does not derive income from a business of holding financial arrangements.

93 Partner 2's half share of the value of the land and depreciable property: ($920,000 + $100,000) ÷ 2 = $510,000.

94 artner 2's half share of the liabilities: $500,000 ÷ 2 = $250,000.

204. Again, the treatment for the exiting partner and the entering partner follows the same pattern as for trading stock and depreciable property. However, in addition, the exiting partner is not required to perform a base price adjustment calculation, despite s EW 29 (When calculation of base price adjustment required).

Short-term agreements for sale and purchase – s HG 9

205. Section HG 9 applies to the extent to which an exiting partner disposes of a short-term agreement for sale and purchase. "Short-term agreement for sale and purchase" is defined in s YA 1. A short-term agreement for sale and purchase is an excepted financial arrangement, except for a party who makes an election under s EW 8.

206. Again, the treatment for the exiting partner and the entering partner follows the same pattern as for trading stock, depreciable property, and financial arrangements.

Specified livestock that includes female breeding livestock – s HG 10

207. Section HG 10 applies to the disposal of specified livestock that is female breeding livestock. Section HG 10 is an elective provision that applies for an entering partner if the entering partner files a return of income that applies the section (s HG 3(3)). The section applies only if the partners use the national standard cost scheme or the cost price method for specified livestock.

208. The effect of s HG 10 applying is that s EC 26B (entering partner's cost base) may apply to the entering partner for the purposes of determining the value of the specified livestock at the end of the income year for the purposes of s EC 2.

Where the safe harbour rules do not apply

209. As discussed above, where the safe harbour rules apply, an entering partner takes on the cost base and acquisition date of the exiting partner for the partnership interests acquired. The entering partner also takes on the purposes or intentions of the partnership that applied when the exiting partner acquired the partnership interests.

210. If the safe harbour rules do not apply on a change of partners, the entering partner will have a cost base for the partnership interests that is based on the amount paid, or the amount they are treated as having paid, for the interests. In this case, it is possible for the entering partner's cost base, as a proportion of the total of the cost bases of all partners, to be greater than the entering partner's partnership share. For example, on acquiring a one-third interest in a partnership, $20 of the purchase price for the partnership interest might be allocated to the acquisition of a one-third interest in an item of property owned by the partnership (based on the current market value of the property). The continuing partners', who now also each have a one-third interest in the property, might each have a cost base for their one-third interest of $10.

211. The entering partner may also have a new acquisition date for the interest in partnership property acquired with the partnership share (unless some other relief applies under the ITA), based on the date the partnership interest is acquired by the entering partner.

212. The entering partner will have the purposes and intentions of the partnership in relation to partnership property that are held by the partnership on the date the partnership share is acquired. If the partnership's purposes or intentions have changed over time, this means that the entering partner can be treated as having a different purpose or intention than the other partners with respect to partnership property, for example.

213. The above means that it may be necessary, for each partner, to keep track of cost base, acquisition date, and purposes and intentions regarding partnership property.

Attribution of amounts where there is a change in partners

214. Where partners change (or where a change in partnership share occurs) during the partnership's income year, the entering and exiting partners can choose whether the exiting or entering partner will claim deductions for some or all the expenditure or loss incurred in the income year before the change in partners. This allows an entering partner to claim a deduction despite not being a partner (or not having the additional partnership share) when the expenditure or loss was incurred. However, other deductibility tests must be met, and only one of the exiting or entering partner can claim a deduction for such expenditure.[95]

95 Section HG 2(3). *Tax Information Bulletin* Vol 20, No 8 (September/October 2008): at 6.

215. The ITA does not contain a similar rule for income derived by partners. Where there has been a change of partners (or a change in partnership share) during the partnership's income year, the attribution of income between exiting and entering partners will depend on the time of derivation for the income or the terms of the partnership agreement if provision has been made in the partnership agreement for the allocation of income between the exiting and entering partners. The preparation of part-year financial statements may assist partners to satisfy the burden of proving that a correct allocation has been made.

216. The partnership agreement can be relevant because the partner's right to income originates in the agreement between the partners. In contrast, an agreement between an exiting and entering partner concerning the right to receive income derived from the partnership by the exiting partner while they were a partner (or held the partnership share) will not affect who derives the income for tax purposes.[96]

Final dissolution

217. The following applies when a partnership is finally dissolved by agreement of the partners, court order, or otherwise, and the partnership's business will not continue to be carried on in partnership.

218. When the partnership is finally dissolved, a partner will generally:

- sell their partner's interests in the partnership property to an unassociated third party;
- keep their interest (and potentially acquire other partners' interests); or
- sell their partner's interest to an associated party (which might include a new partnership or other business structure).

219. Subject to two exclusions, s HG 4 ensures the partner's interests,[97] if not actually disposed of for market value, are treated as such. It does this by treating a partner as:[98]

- disposing of all their partner's interests in the partnership, immediately before the dissolution, to a (notional) single third party for a payment equal to the interests' market value; and
- re-acquiring all their partner's interests immediately after the dissolution, from the third party for a payment equal to the interests' market value.

220. Where the above treatment applies, actual amounts the partner receives in relation to the final dissolution of the partnership are ignored.[99] The tax effects of dissolution are determined based on the deemed disposal and reacquisition described above.

221. As noted above, s HG 4 is subject to two exclusions.

First exclusion to s HG 4

222. The first exclusion is that s HG 4 does not apply to the extent that a partner disposes of their interest to an unassociated third party.[100] With these disposals, the partner accounts for tax based on the amounts that they receive, which are assumed to be market values. This is illustrated in Example | Tauira 9.

96 It is considered that this is consistent with principles applied in *Hadlee & Sydney Bridge Nominees Ltd v CIR* (1993) 15 NZTC 10,106 (PC).

97 "Partner's interests" means the relevant interests in rights and obligations and other property, status, and things a partner has as a result of applying s HG 2.

98 Section HG 4(2).

99 Section HG 4(3).

100 Section HG 4(4).

Example | Tauira 9 - Sale to non-associated party

Facts

Partnership A has two partners, partners 1 and 2, with equal partnership shares. The partners decide to sell the partnership business to company A for $300,000 and dissolve the partnership. Neither partner is associated with company A.

Tax treatment

Because the partnership is dissolved and will not continue to be carried on in partnership, the safe harbour rules do not apply.

Also, because the partners have sold their partner's interests to a person who is not associated with them, s HG 4 does not apply.

The partners need to account for tax on the disposal based on the $300,000 sale price they received for the business.

After allocating the sale price to various partnership assets, the partners determine that they have depreciation recovery income and income from the sale of trading stock. The question of how a global purchase price is allocated to particular assets is a separate topic outside the scope of this statement.[101]

Variation

This variation uses the same facts as above except the partners are associated with Company A and Company A pays the partners only $260,000, despite the market value being $300,000.

Tax treatment

Section HG 4(2) applies to treat the partners as disposing of their partner's interests to a notional third person (not company A) for the market value of those interests and then reacquiring them from the notional third person for the market value.

After that, the $260,000 amount they receive from company A for the actual disposal of the interests is ignored (s HG 4(3)).

Where one partner acquires the interests of the other partners

223. The first exclusion to s HG 4 applies, in the case of a general partnership, where one partner acquires the partner's interests of the other partners so there are no longer two or more partners, and therefore there is a dissolution of the partnership by operation of law. A general partnership must have two or more partners.[102]

224. In this situation, the partner that acquires the other partners' interests is also treated as disposing of their own interests. The definition of "dispose" in s YA 1, for a partner, includes surrendering or extinguishing some or all of their partner's interests. In this situation, the partner's interests in the partnership property are extinguished because the interests have fundamentally changed from being an undivided share in the property to the exclusive ownership of the property. Further, although the definition of dispose excludes the situation where a partner's interests may be treated as disposed of by operation of law because another partner disposes of that partner's interests, the definition provides that this does not apply on the final dissolution of a partnership when the partnership's business will not continue to be carried on in partnership. In this situation, generally, the partner who acquires the other partners' interests should treat their own partner's interests as having been disposed of for market value. This is illustrated in Example | Tauira 10.

101 Guidance on purchase price allocation rules is provided in *Tax Information Bulletin* Vol 33, No 6 (July 2021): 28.

102 A limited partnership can have one limited partner. However, it must also have a general partner.

Example | Tauira 10 - Partner acquiring other partners' interests

Facts

Partnership A has two partners, partners 1 and 2, with equal partnership shares. Partner 1 wishes to retire, so the partners agree that partner 2 will purchase partner 1's partner's interests. Partners 1 and 2 are not associated. One of the partnership assets is residential land that was acquired with the intention of disposal in terms of s CB 6.

Tax treatment

The purchase causes a final dissolution of the partnership because only one partner remains.

Because the partnership is dissolved and the partnership business will not continue to be carried on in partnership, the safe harbour rules do not apply.

Also, because partner 1 sold their partnership interests to a person who is not associated with them, s HG 4 does not apply.

However, because the partnership is finally dissolved and the partnership business will not continue to be carried on in partnership, both partners are treated as having disposed of their partner's interest. The definition of "dispose" in the ITA applies to this situation.

The result is that partner 1 needs to account for tax on the disposal of their partner's interest based on the amount they receive from partner 2.

Partner 2 also needs to account for tax on the disposal of their partner's interest. Partner 2 should treat the disposal as having occurred at market value.

After allocating the disposal amounts to the various partnership assets, the partners return income from the disposal of their interests, including income derived under s CB 6 from the disposal of the land acquired with the intention of disposal.

Partner 2's future cost base is the total of the amount paid to partner 1 and an amount equal to the market value of partner 2's partner's interest on disposal.

Bright-line test

The bright-line test in s CB 6A does not apply in this example because the disposal of the land is covered by s CB 6 (Disposal: land acquired for purpose or with intention of disposal). Section CB 6A does not apply if any of the land rules in ss CB 6 to CB 12 apply.

However, if the bright-line test did apply (if, among other things, there was no evidence of an intention of disposal for the land), it would be necessary to consider whether partners 1 and 2 would be eligible for rollover relief in relation to the land. The disposal of the interest in land is a transfer from a partnership to a partner that would potentially be covered by s FD 1 (Relief from bright-line test for transfers between associated persons). The application of the bright-line rules to partnerships is outside the scope of this statement, so is not discussed further.

Second exclusion to s HG 4

225. The second exclusion is provided for partnerships of partners who are married to each other, in a civil union together, or in a de facto relationship together. This exclusion applies if:[103]

- immediately before the dissolution, there are only two partners of the partnership and they are married to each other, in a civil union together, or in a de facto relationship together; and
- the dissolution of the partnership:
  - is caused by death of a partner; or
  - relates to the settlement of relationship property; and
- on dissolution, all partner's interests of one partner are transferred to the other person (ignoring any intervening transfer to an executor or administrator); and
- the transfers of those partner's interests are subject to provisions in subparts FB or subpart FC (which relate to transfers of relationship property and gifts, respectively), and those provisions treat the transfers as disposals for amounts that are not the interests' market values.

226. This means, in the case of death for example, where the surviving partner inherits the deceased partner's interests, there is a tax base rollover[104] in relation to both the:

- deceased partner's interest that the surviving partner inherits; and
- surviving partner's own partner's interest.

227. When the partnership rules were first introduced, in the case of death, the tax base rollover applied only to the deceased partner's interest.[105] Despite that relief, the surviving partner potentially had to account for tax on the disposal of their own partner's interest caused by the dissolution of the partnership. This was seen as inappropriate,[106] so tax base rollover relief was extended to the surviving partner's interest as well.[107] This is illustrated in Example | Tauira 11.

Example | Tauira 11 - Dissolution on death of a partner

Facts

Partner 1, a partner of partnership A, dies. Before partner 1's death, partnership A had two partners, partners 1 and 2.

Partners 1 and 2 were in a de facto relationship. After partner 1's death, partner 2 decides to carry on the business herself.

Tax treatment

Partner 1's death results in the dissolution of the partnership.

The executor of partner 1's estate distributes all partner 1's partner's interests to partner 2. This distribution is treated as a transfer of property under a settlement of relationship property under subpart FB (subpart FB normally only applies where there is a settlement under a relationship property agreement, but s FC 3(2) treats a transfer by an executor like in this example as if it was a transfer of property under a settlement of relationship property under subpart FB.). In this case, because of the nature of the property (trading stock), partner 1's partner's interests are treated as being transferred at their original cost.

The transfer of the property is not subject to s HG 4(2). The exclusion in s HG 4(5) applies.

Partner 2 will hold what were partner 1's partner's interests on the same basis as they were held by partner 1. Partner 2 is treated as having the same cost as partner 1, having acquired the property on the same date as partner 1, and holding the property with the same intention and purpose as partner 1. If partner 2 subsequently sells the property, she will need to account for any tax on the sale.

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103 Section HG 4(5).

104 This means they do not have to account for tax on this disposal event, but they may need to account for tax when the asset is subsequently disposed.

105 New legislation: Taxation (Limited Partnerships) Act 2008 *Tax Information Bulletin* Vol 20, No 8 (September/October 2008): 4, at 8.

106 Until the property is sold by the surviving partner to a third party, the surviving partner may not have the cash to pay for any liability arising from a deemed disposal on dissolution of the partnership.

107 Section 270 of the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009.

Withholding tax considerations for payment made by a partnership

228. The following is about the withholding tax obligations that arise for payments made **by a partnership**.

PAYE on payments made by a partnership

One employer

229. The transparent tax treatment of partnerships is modified for the purposes of determining the frequency with which a partnership, as an employer, must pay PAYE deductions to the Commissioner.

230. In the PAYE rules, s RD 4 specifies when, and with what frequency, an employer must pay PAYE deductions to the Commissioner. Under s RD 4(2)(a), an employer must pay amounts to the Commissioner monthly if the employer has, in the relevant tax year,[108] gross amounts of tax of less than $500,000 withheld under s RA 5(1)(a) and (c) (which includes PAYE, fringe benefit tax (FBT) and employer's superannuation contribution tax (ESCT).

231. The transparent tax treatment of partnerships under s HG 2 would result in a dilution of the threshold in s RD 4(2)(a) as each partner would be treated as withholding a portion of the PAYE. However, s RD 4(6)(b) avoids the dilution by providing that for the purposes of s RD 4, all partners in a partnership are treated as one employer.[109]

Liability

232. Where a partnership makes a PAYE income payment, the liability to withhold and pay PAYE to the Commissioner falls on:
    - in a general partnership, all the partners; and
    - in a limited partnership, the general partners.

233. The liability to withhold and pay PAYE to the Commissioner is imposed on an employer. "Employer" in this context means a person who is liable to pay a PAYE income payment.[110] This includes all partners of a general partnership (as all partners are jointly liable under a contract of employment or service entered in the name of the partnership[111]) and the general partners of a limited partnership.

234. A person will be liable for the PAYE of a partnership only if the liability to pay PAYE arose while they were a partner.[112] This means a person who joins an existing partnership is not liable for PAYE withheld before they joined the partnership. It also means a person who has ceased being a partner can be liable for PAYE withheld before they ceased being a partner.

235. The same treatment applies for the purposes of Fringe Benefit Tax (FBT) and Employer's superannuation contribution tax (ESCT) as these taxes are also applied to an employer.

Resident withholding tax and non-resident withholding tax on payments made by a partnership

236. The resident withholding tax (RWT) and non-resident withholding tax (NRWT) rules apply to a person who pays an amount of resident passive income or non-resident passive income, respectively. These rules apply to a partnership (general or limited) that pays such amounts.[113]

108 The current tax year for new employers or the previous tax year otherwise.

109 Section RD 4(6).

110 Section YA 1.

111 Section 22(1) of the PLA.

112 Section 22(1) of the PLA.

113 The question of whether the RWT and NRWT rules apply to a partnership paying an amount or to the partners of a partnership paying an amount appears to be academic. In any event, the partners of the partnership are jointly liable to withhold and pay RWT and NRWT to the Commissioner if the partnership or partners pay an amount that requires withholding.

237. A partnership might pay an amount of resident or non-resident passive income if, for example, it has borrowed money and is paying interest on the amount borrowed. A partnership may also pay an amount of non-resident passive income if it pays a royalty that has a source in New Zealand.[114] A partnership cannot pay a dividend because a partnership is not a company.[115]

238. For there to be an obligation to withhold RWT, the payer of an amount must:[116]

- be resident in New Zealand; or
- carry on a "taxable activity"[117] in New Zealand through a fixed establishment in New Zealand.

239. Residency is not a concept that applies to a partnership – no residency tests exist for partnerships.[118] Further, the residency of the partners of a partnership may vary. However, by virtue of s HG 2, the partners of a partnership can carry on a taxable activity in New Zealand and have a fixed establishment. This applies to both general and limited partnerships. Therefore, a partnership can have an obligation to withhold RWT.

240. For an obligation to withhold NRWT to exist there must be a payment of non-resident passive income. There is no requirement for the payer to be resident or to carry on a taxable activity, as there is for RWT. However, for an amount to be non-resident passive income, the income must have a source in New Zealand.

241. Interest income has a source in New Zealand if it relates to money that is lent in New Zealand. Therefore, a partnership can have an obligation to withhold NRWT if it is paying interest to a non-resident on an amount the partnership borrowed in New Zealand.

242. The obligation to withhold and the liability to pay RWT or NRWT to the Commissioner is a partnership obligation and liability. This is because it arises from the business carried on by the partnership.

243. In the case of a general partnership, every partner is liable jointly with the other partners for all debts and obligations of the partnership (including withholding and paying RWT or NRWT). However, a partner is liable only if the debts or obligations are incurred while the partner is a partner.[119] Joint liability means one of the partners could be liable for the whole amount if something were to happen to the other partners. Joint liability can be contrasted with several liability where liability is limited to a share of a debt.[120]

244. In the case of a limited partnership, each general partner (if there is more than one) is jointly and severally liable with the limited partnership and the other general partners (if any) for the unpaid debts and liabilities of the limited partnership (including RWT and NRWT). A general partner is liable only if the debts or obligations are incurred while the partner is a partner.[121] Further, a general partner is liable only to the extent that the limited partnership cannot pay those debts or liabilities. A limited partner who does not take part in the management of the limited partnership is not liable for the debts and liabilities of the limited partnership.

114 A royalty has a source in New Zealand if it is paid by a New Zealand resident and is not paid in connection with a business the New Zealand resident carries on outside New Zealand through a fixed establishment outside New Zealand. Under s YD 4(17B), income has a source in New Zealand if, treating all of the partners of a "New Zealand partnership" as resident in New Zealand, the income is treated as having a source in New Zealand under another provision of this section. "New Zealand partnership" is defined in s YA 1. This source rule and the definition of New Zealand partnership is discussed later in this statement. The royalty source rule is one of the other provisions in s YD 4 that the partnership rule can apply to. The combination of the two rules can result in a payment by a "New Zealand partnership" being treated as sourced in New Zealand.

115 Although a limited partnership is a corporate entity, the definition of company excludes all partnerships, including limited partnerships.

116 Section RE 4(2).

117 The ITA makes use of the GST definition of "taxable activity" for the withholding tax purposes. This does not mean that person A must be a registered person or be carrying on a taxable activity for GST purposes.

118 Residence is discussed further from [291].

119 Section 22(1) of the PLA.

120 An example of several liability is in s 22(2) of the PLA, which deals with the liability of the estate of a deceased partner.

121 Section 26(1) of the LPA.

Association

245. A common question that arises in many provisions in the ITA is whether two persons are associated with each other for tax purposes. This section discusses the associated person rules as they apply to partners and partnerships.

246. In summary, a person and a partnership can be associated if:

- in the case of a general partnership, the person is a partner of the partnership;
- in the case of a limited partnership:
  - the person is a general partner of the limited partnership;
  - the person is a limited partner who has, or is treated under an aggregation rule in s YB 12(3) or (4) as having, a partnership share of 25% or more in a right, obligation, or other property, status, or thing of the limited partnership; or
  - the person is not a partner, but is treated under an aggregation rule as having a partnership share of 25% or more in a right, obligation, or other property, status, or thing of the limited partnership;
- the person is a company, and the partnership has a voting or market value interest in the company or an aggregation rule in s YB 3 applies to treat the partnership as holding voting or market value interests in the company; or
- The tripartite relationship rule applies because the person and the partnership are each associated with a common third person.

247. Two persons can also be associated through a partnership under the tripartite relationship rule or under an aggregation test.

248. In some circumstances, a limited partnership can be treated as a company,[122] in which case association may arise under ss YB 2 (two companies) or YB 3 (company and a person other than company).

General partnership and partner

249. A general partnership and a partner of the general partnership are associated persons, regardless of the size of the partner's partnership share.[123]

Limited partnership

General partner and partnership

250. A limited partnership and a general partner of the limited partnership are associated persons.[124]

Limited partner who has partnership shares of 25% or more

251. Association between a limited partnership and a limited partner is determined under s YB 12(2), unless s YB 16B applies.

Whether s YB 16B applies

252. In certain circumstances, s YB 16B provides for association to be tested as if the limited partnership was a company. Under s YB 16B, a limited partnership is treated as a company if:

- a limited partner of the limited partnership is a company; or
- the limited partnership has a voting interest in a company or, if a market value circumstance exists for the company, a market value interest in the company;

253. Further, if a limited partnership is a limited partner of another limited partnership, then both limited partnerships will be treated as companies.

254. Section YB 16B is discussed further from [275].

255. The following considers the application of s YB 12(2) in circumstances where s YB 16B does not apply.

122 Section YB 16B.

123 Section YB 12(1).

124 Section YB 12(1B).

Association under s YB 12(2)

256. Under s YB 12(2), a person and a limited partnership are associated if the person has, or is treated under an aggregation rule in s YB 12(3) or (4) (discussed next) as having, a partnership share of 25% or more in a right, obligation, or other property, status, or thing of the limited partnership.

257. If a limited partner does not have a partnership share of 25% or more on their own, they might be treated as reaching this threshold under an aggregation rule (discussed next).

Aggregation rules

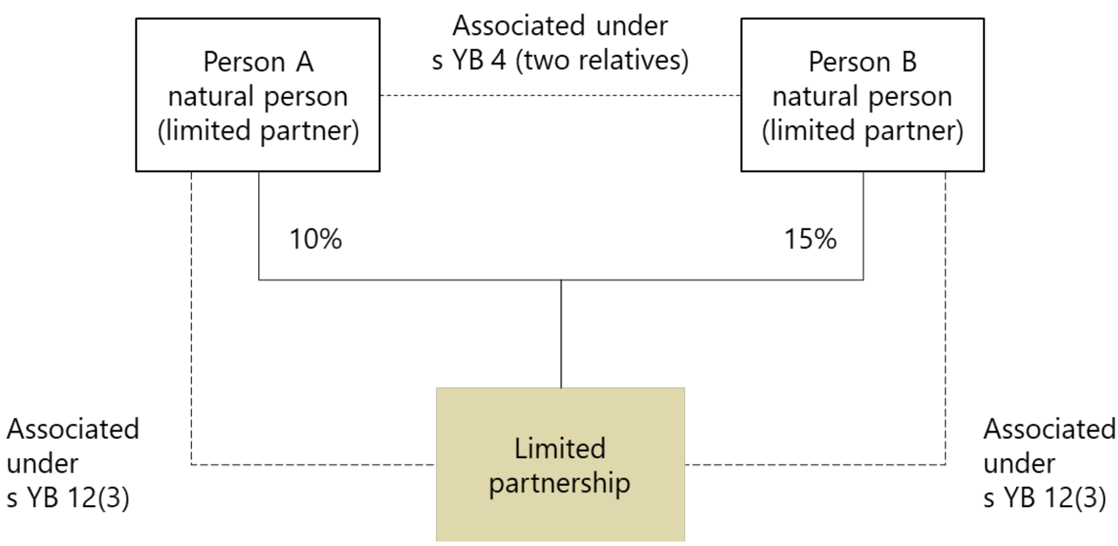
258. Under the aggregation rules in s YB 12(3) and (4), the partnership shares of a limited partner and a person associated with the limited partner under certain associated person provisions can be aggregated. Section YB 12(3) provides a general aggregation rule and s YB 12(4) provides an aggregation rule for land provisions. The only difference is that s YB 12(4) specifies a narrower set of associated person provisions for the required association.[125]

259. The aggregation rules are designed to prevent the associated person test in s YB 12(2) being circumvented by placing partnership share in the hands of an associated person.

260. The aggregation rules states that if a person (person A) and another person (person B) are associated under certain associated person tests, person A is treated as holding anything held by person B.

261. The aggregation rules can have two related effects:
   - Where both persons A and B are limited partners, the aggregation rules can treat each person as also holding the partnership share of the other person. This is because the aggregation rules are applied concurrently to each limited partner. This means that they are each treated as holding the partnership shares that the other holds in addition to their own partnership shares. In this way, even if person A or person B would not, on their own, satisfy the 25% threshold, they might satisfy the threshold with their combined partnership shares. This is illustrated in Diagram | Hoahoa 4.
   - The aggregation rules can also extend association with a partnership to an associate of a partner, even if the associate has no partnership share, provided the 25% threshold is satisfied by the partner or partners with whom association is established. This is referred to in this statement as the extension effect. This is illustrated in Diagram | Hoahoa 5.[126]

Diagram | Hoahoa 4 – Limited partnership association – aggregation rule



125 Section YB 12(3) applies where the association arises under ss YB 2 to YB 11 and YB 14. Section YB 12(4) applies where the association arises under ss YB 2, YB 3, YB 4(1)(b) and (2) to (4), YB 7, YB 8, YB 10, YB 11, and YB 14.

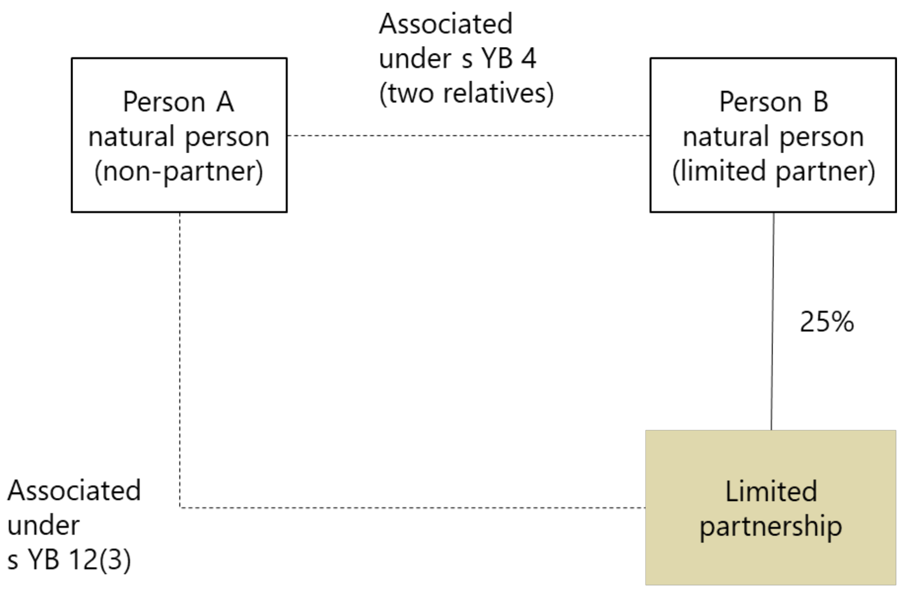
126 The two related effects are reflected in the New definitions of associated persons (special report, Policy Advice Division, Inland Revenue, October 2009). The special report describes (at 24) the partnership aggregation test as similar to the company and person other than a company aggregation test in s YB 3. Examples (at 10 to 12) for the company and person other than a company aggregation test show the two related effects.

An amendment was made to clarify that s YB 12(3) and (4) have the extension effect. The amendment did this by replacing the reference in s YB 12(2) to "limited partner" with "person". See cl 138(1) of the Taxation (Annual Rates for 2024–25, Emergency Response, and Remedial Measures) Act 2025.

Non-partner treated as having partnership share of 25% or more

262. A non-partner who is treated as having a partnership share of 25% or more in a limited partnership because of an aggregation rule is associated with the limited partnership. The aggregation rules are discussed from [260]. Association between a non-partner and a limited partnership is illustrated in Diagram | Hoahoa 5.

Diagram | Hoahoa 5 – Limited partnership association - aggregation rule, extension effect



Association between partners

263. Two partners of a partnership (a general or limited partnership) are not associated with each other merely because they are both partners of the partnership. Although both partners may be associated with the partnership, the tripartite relationship test (discussed below) does not apply to associate each partner because it would require the same test of association to be applied twice.[127]

264. Two partners can be associated with each other under other associated person tests, for example if the two partners are within two degrees of blood relationship.[128]

General partnership has an ownership interest in a company

265. A general partnership may be associated with a company under s YB 3 by holding voting or market value interests in the company of 25% or more.[129]

266. If a limited partnership holds a voting or market value interest in a company, s YB 16B applies, in which case association between the limited partnership (treated as a company) and the company is determined under s YB 2.

267. For the purposes of s YB 3, s HG 2 does not treat the partners of a general partnership as holding the voting or market value interests in a company that are held by the general partnership. Section HG 2 applies to a section in the ITA only if the context does not require otherwise. The context of s YB 3 requires otherwise. Part of this context is the existence of the associated person test in s YB 12. The test in s YB 12 would have limited application if partnerships were not sometimes associated with another person.

268. However, s YB 12 works with the tripartite relationship test in s YB 14 (discussed at [273]) to associate a partner of a general partnership with a person with whom the general partnership is associated, which could include a company owned by the general partnership.

127 Section YB 14(1)(b).

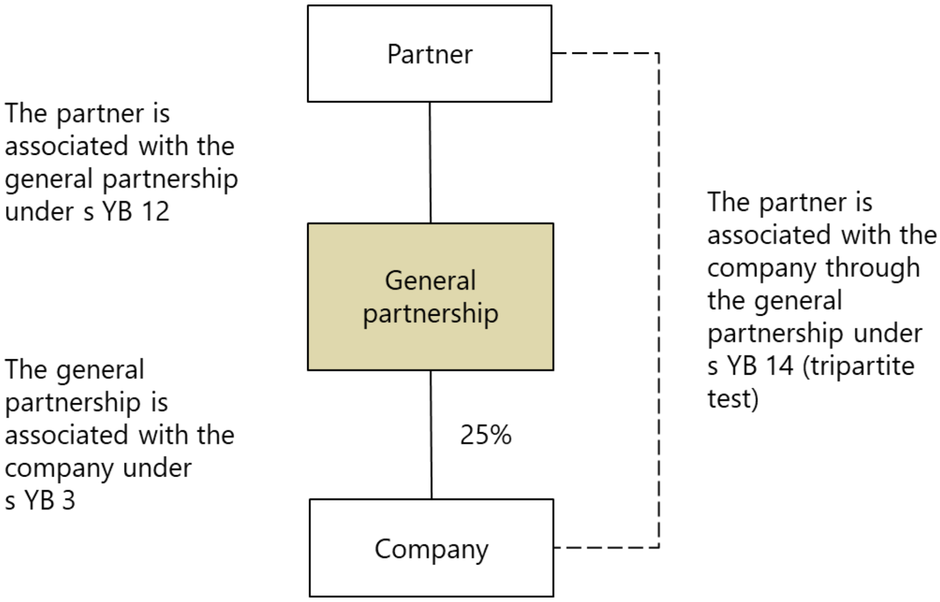
128 Section YB 4(1)(a). Two degrees of blood relationship includes two people who are married or are in civil union or de facto relationship, a parent and child, a grandparent and grandchild, or two siblings, for example. It does not apply to cousins or to the relationship between a person and great-grandparent or to their aunt or uncle, for example.

129 This is consistent with A guide to associated persons definitions for income tax purposes – IR620 (guide, April 2017).

269. The aggregation rules in s YB 3(3) or (4) could also associate a partner of a general partnership and a company owned by the partnership. See from [274].

270. Association through a general partnership having an ownership interest in a company is illustrated in Diagram | Hoahoa 6.

Diagram | Hoahoa 6 – Tripartite association

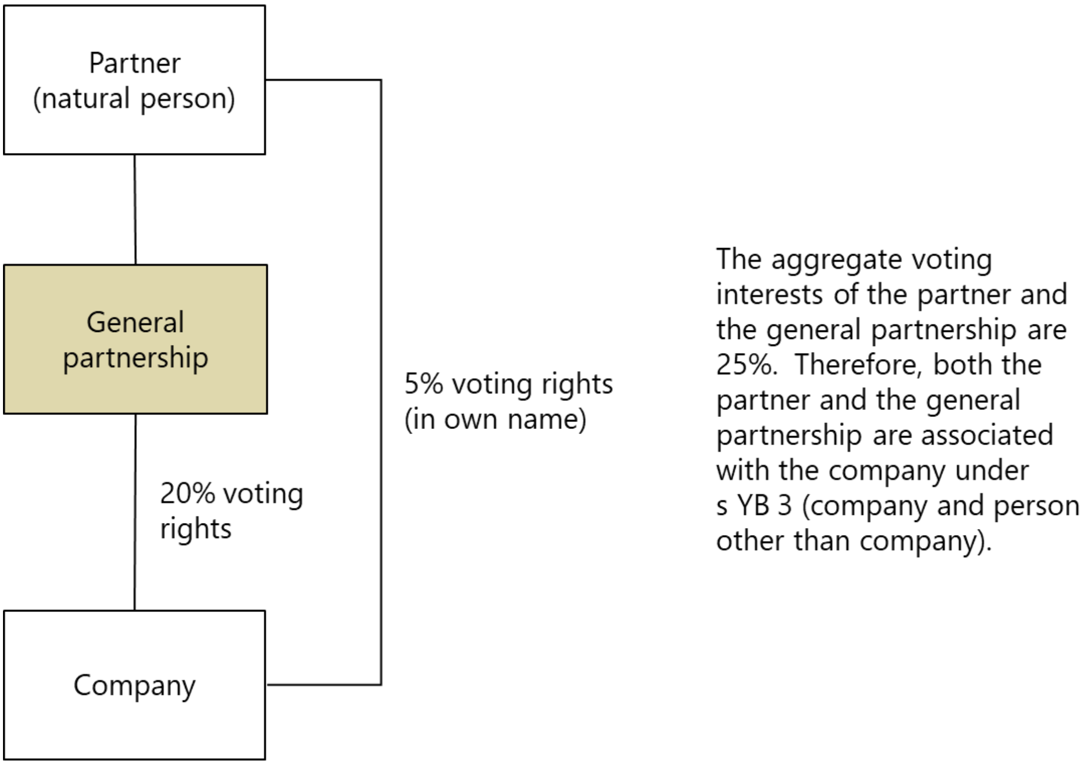


271. Where a partner of a general partnership holds voting or market value interests in a company in their own name, these interests are aggregated with interests in the company held by the general partnership.[130] This could result in both the partner and the partnership being associated with the company. This is illustrated in Diagram | Hoahoa 7 and Example | Tauira 12 – Aggregation rule.

272. In the case of a limited partnership with a non-company limited partner, the tripartite relationship test will not cause the limited partner to be associated with a company owned by the limited partnership by reason of the partnership and company interests held. This is because a limited partnership is treated as a company for the purposes of applying the tripartite relationship test. This includes the exception to the tripartite relationship test in s YB 14(2). This exception states that the tripartite relationship test does not apply to associate two persons (persons A and B) where person B is associated with the common third party (person C) under s YB 2, and person A is associated with person C under s YB 3. A non-company limited partner (person A) could be associated with the limited partnership (person C, treated as a company) under s YB 3, and the limited partnership could be associated with the company under s YB 2. In this case, the exception to the tripartite relationship test will apply. Note that s YB 16B will also apply in this case because the limited partnership owns an interest in a company. Section YB 16B may result in the partner and the company owned by the limited partnership being associated under s YB 3, even without the tripartite test. Section YB 16B is discussed further from [275].

130 Under s YB 3(3).

Diagram | Hoahoa 7 – Company and person other than company aggregation – interests held by partnership and a partner in their own name



Example | Tauira 12 – Aggregation rule

Facts

General partnership A holds 15% of the shares in a company. Two of general partnership A's partners, partners 1 and 2 (both natural persons), also each hold (in their own names, not through the partnership) 5% of the shares in the company.

Tax treatment

Individually, none of partnership A, partner 1 or partner 2 is associated with the company, but because of the aggregation rule, all three are treated as holding 25% voting rights in the company, so all three are associated with the company under s YB 3 (company and person other than company).

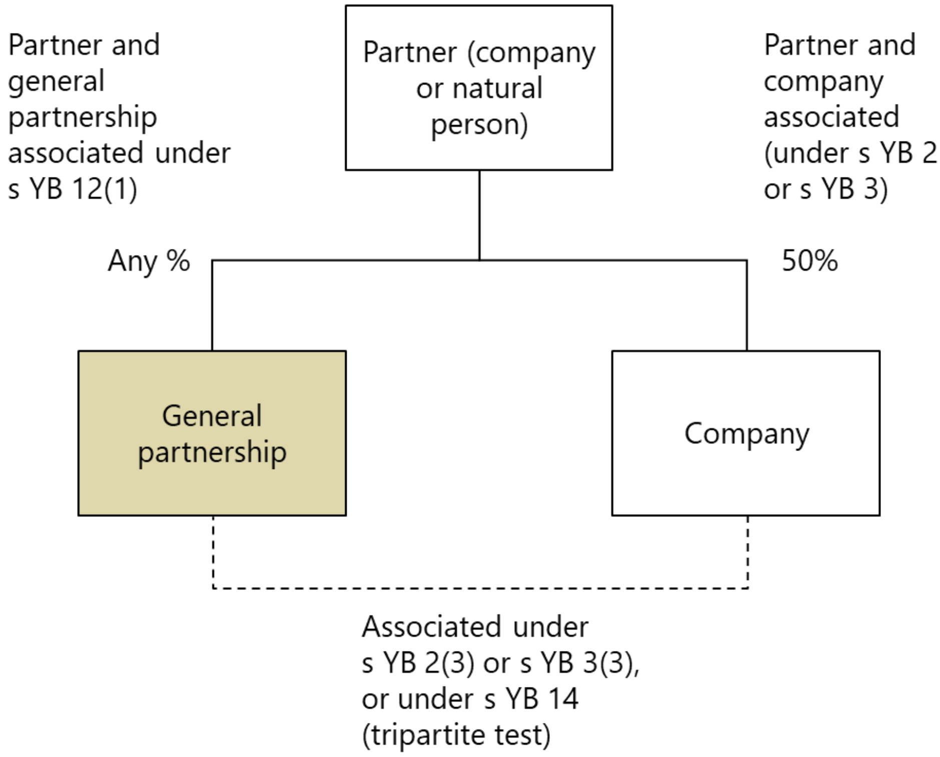
Association through the tripartite relationship test

273. If a partnership and a partner are associated, then under the tripartite relationship test the following may arise:

- A partner and a person that the partnership is associated with can be associated. For example, a partner of a general partnership will be associated with a company if the partnership holds voting interests of 25% or more in the company. This is illustrated in Diagram | Hoahoa 6.
- The partnership and a person that a partner is associated with can be associated.[131] For example, a general partnership can be associated with a company that is associated with a partner of the general partnership under s YB 2 (two companies). This could be relevant to association under the land rules where the partnership, for example, is carrying on a business of dealing in land. This is illustrated in Diagram | Hoahoa 8.

131 A limited partnership and a person a limited partner is associated with might also be directly associated under the partnership aggregation rule in s YB 12(3) or (4).

Diagram | Hoahoa 8 – Person who is a partner of general partnership and owns 50% of a company



Association through other aggregation tests

274. The aggregation tests in s YB 2(3) and (4) and s YB 3(3) and (4) can also affect association in arrangements involving partnerships. This is illustrated in Diagram | Hoahoa 8, where the general partnership is associated with the company under ss YB 2(3) or YB 3(3). This is because the partnership is treated as holding the partner's 50% ownership interest in the company.

Section YB 16B – Limited partnership treated as a company

275. As noted above, under s YB 16B, in certain circumstances a limited partnership is treated as a company for the purposes of determining association.[132] Treating the limited partnership as a company can result in ss YB 2 (two companies) or YB 3 (company and a person other than a company) applying to determine association.

276. Under s YB 16B, a limited partnership is treated as a company if:

- A limited partner of the limited partnership is a company; or
- the limited partnership has a voting interest in a company or, if a market value circumstance exists for the company, a market value interest in the company.

277. Further, under s YB 16B, if a limited partnership is a limited partner of another limited partnership, then both limited partnerships will be treated as companies.

278. The treatment of the limited partnership as a company applies for the purposes of the following sections:

- Section YB 2 (two companies). If s YB 16B applies, s YB 2 will be the key section in determining association between a limited partnership and a company or between two companies.
- Section YB 3 (company and a person other than a company).
- Section YB 12(2), (3) and (4) (limited partnerships and holders of 25% partnership shares, aggregation rules). Section YB 12(2), and therefore (3) and (4), apply only if s YB 16B does not apply.
- Section YC 4 (look-through rule for corporate shareholders).

132 Section YB 16B.

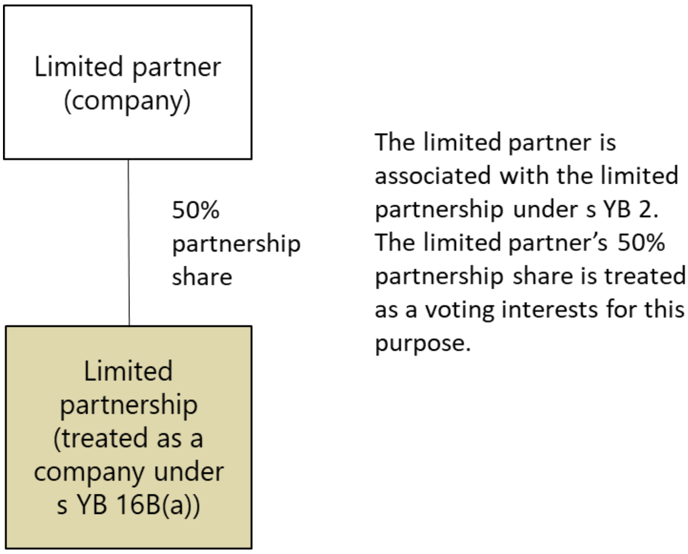
Limited partnership and limited partner

279. If s YB 16B applies to treat a limited partnership as a company, then association between the limited partnership and a limited partner[133] will be tested under s YB 2 or s YB 3, depending on whether the partner is a company or not.[134]

If the limited partner is a company

280. If the limited partner is a company, association will be tested under s YB 2. Under s YB 2, two companies are associated if a group of persons exists whose total voting or market value interests in each company are 50% or more. Section YB 2 can apply to associate a limited partnership and a company because, if s YB 16B applies, the limited partnership is treated as a company for the purposes of s YB 2, and the company's partnership share in the limited partnership is treated as a voting interest. This is illustrated in Diagram | Hoahoa 9.

Diagram | Hoahoa 9 – Limited partnership and limited partner (company)



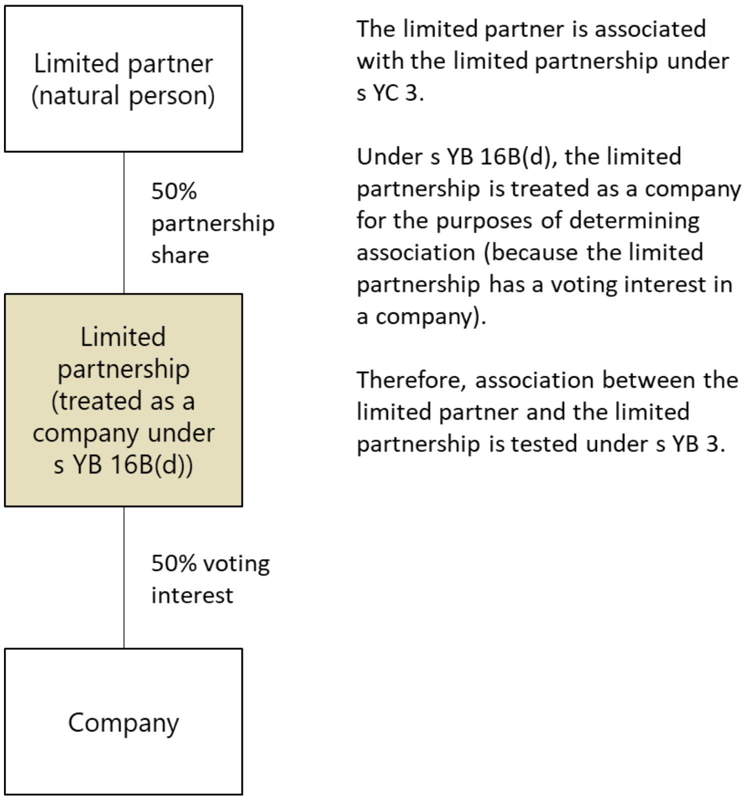
If the limited partner is not a company

281. If the limited partner is not a company, association will be tested under s YB 3(1). Under s YC 3(1), a person and a company are associated if the person has a voting interest in the company of 25% or more. Section YB 3 can apply to associate a limited partnership and a limited partner because, if s YB 16B applies, the limited partnership is treated as a company for the purposes of s YB 3, and the limited partner's partnership share in the limited partnership is treated as a voting interest. This is illustrated in Diagram | Hoahoa 10

133 If an aggregation rule applies, this could also apply to a person associated with a limited partner who is treated as holding the limited partner's partnership share. However, for ease of reference this section will simply refer to a limited partner.

134 Remember that s YB 16B could apply because the limited partnership has voting or market value interests in a company or because it has a partnership share in another limited partnership or another limited partnership as a partnership share in it.

Diagram | Hoahoa 10 – Limited partnership and limited partner (not a company)

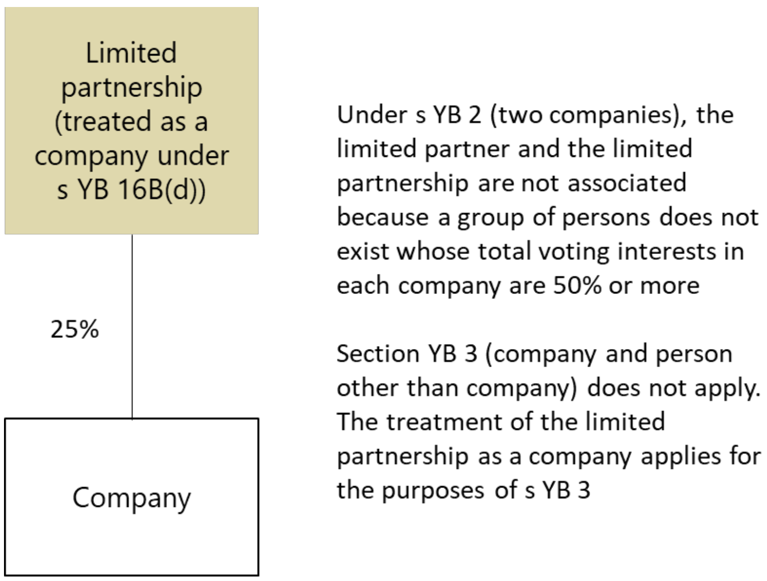


Association between a limited partnership and a company owned by the limited partnership

282. If s YB 16B applies to treat a limited partnership as a company, then association between the limited partnership and a company owned by the limited partnership will be tested under s YB 2 (Two companies). The treatment of the limited partnership as a company excludes the application of s YB 3 (Company and person other than a company).

283. Under s YB 2, two companies are associated if a group of persons exists whose total voting or market value interests in each company are 50% or more. This is illustrated in Diagram | Hoahoa 11.

Diagram | Hoahoa 11 – Limited partnership with voting interests in company



Association between two limited partnerships

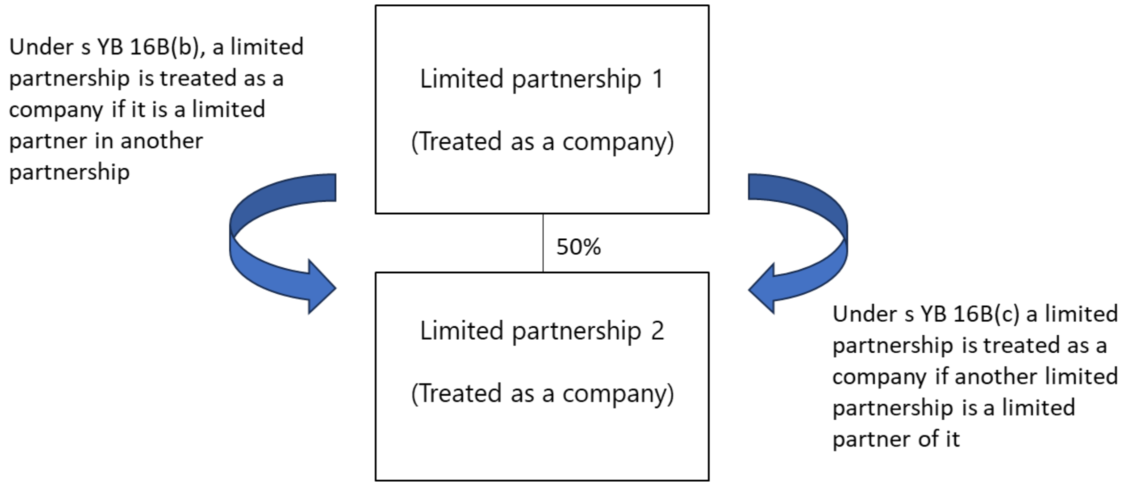
284. Section YB 16B(b) treats a limited partnership as a company if the limited partnership is a limited partner of another limited partnership.

285. Also, s YB 16B(c) treats a limited partnership as a company if another limited partnership is a limited partner of the limited partnership.

286. Applied concurrently in an arrangement where one limited partnership is a limited partner of another limited partnership, paras (b) and (c) result in both limited partnerships being treated as companies.

287. Where one limited partnership is a limited partner of another limited partnership, association between them will be determined under s YB 2. Section YB 2 can apply to associate a limited partnership that is a limited partner of another limited partnership because, if s YB 16B applies, the limited partnerships are both treated as companies for the purposes of s YB 2, and the first limited partnership's partnership share in the other limited partnership is treated as a voting interest. This is illustrated in Diagram | Hoahoa 12.[135]

Diagram | Hoahoa 12



Application of s YC 4 – look-through rule

288. If s YB 16B applies in one of the scenarios listed in that section, the limited partnership, or limited partnerships, are treated as companies and partnership shares in the limited partnerships are treated as voting interests. This treatment applies for the purposes of s YC 4.

289. Section YC 4 provides a look-through rule which applies where one company (intermediate company[136]) has, or is treated as having, an ownership interest in another company (the subject company[137]). The look-through mechanism operates by treating a person with an ownership interest in an intermediate company as having a portion of the intermediate company's ownership interest in the subject company. This portion is calculated by multiplying the person's ownership interest in the intermediate company with the intermediate company's ownership interest in the subject company.

290. If s YB 16B applies, a limited partnership could fill the role of the intermediate company or the subject company, depending on the situation, and voting interests or partnership shares can be attributed to an ultimate shareholder or limited partner for the purposes of determining association.

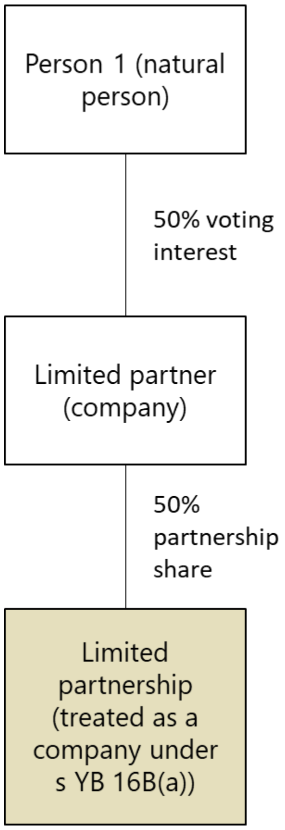
135 In terms of the requirement in s YB 2(1), this means that the partners of limited partnership 1 are a group of persons whose total voting interests in each company (here, the two limited partnerships treated as companies) are 50% or more.

136 Referred to as the shareholder company in s YC 4.

137 Referred to as the issuing company in s YC 4.

291. This is illustrated in Diagram | Hoahoa 13, Diagram | Hoahoa 14, and Diagram | Hoahoa 15.

Diagram | Hoahoa 13 – Application of s YC 4 – limited partnership as subject company

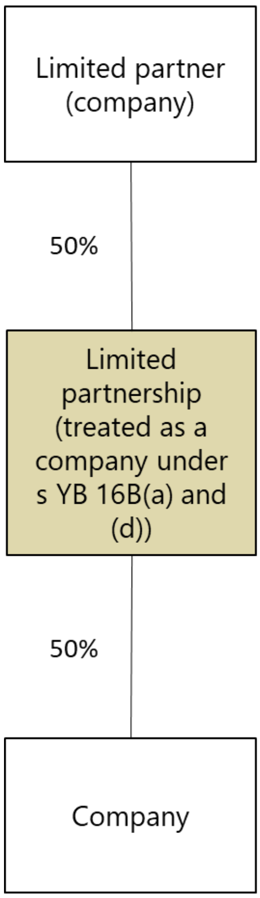


Under s YC 4, the limited partnership is in the position of the subject company.

Person 1 is treated as having a 25% partnership share in the limited partnership (50% voting interest × 50% partnership share).

Person 1 is therefore associated with the limited partnership under s YB 3.

Diagram | Hoahoa 14 – Application of s YC 4 – limited partnership as intermediate company

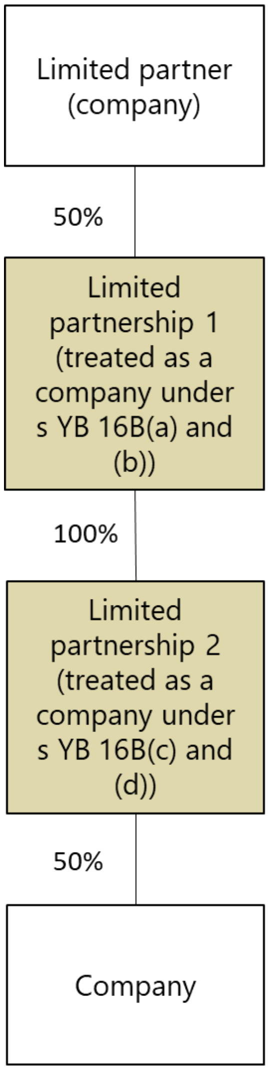


Under s YC 4, the limited partnership is in the position of the intermediate company.

The limited partner is treated as having a portion of the limited partnership's voting interests in the company. The limited partner's portion is 25% (50% partnership share × 50% voting interest).

Under s YB 2, the limited partner and the limited partnership are associated. So are the limited partnership and the company. However, the limited partner and the company are not associated because the limited partner is treated as only holding 25% of the voting interests.

Diagram | Hoahoa 15 – Application of s YC 4 – two limited partnerships



Under s YC 4, look-through applies to both limited partnerships.

Under s YB 2, the limited partner is associated with limited partnership 1 (50% partnership share) and limited partnership 2 (50% partnership share, 50% × 100%). However, the limited partner is not associated with the company as the limited partner has voting interests of only 25% (50% × 100% × 50%).

The two limited partnerships are associated with each other and with the company under s YB 2.

Residency

292. Given the transparent income tax treatment of partnerships, residency is generally relevant to the partners of a partnership, not to the partnership itself. Consistent with this, no residency tests exist for general or limited partnerships.

No residency tests for partnerships

293. A general partnership is not an entity in its own right; it is a relationship between partners. Because it is not an entity, a general partnership does not fall within any of the residency tests in the ITA.

294. A limited partnership is a separate legal entity. However, partnerships (including limited partnerships) are excluded from the definition of company in section YA 1. Therefore, the company residency tests do not apply to a limited partnership.

295. A limited partnership is not resident in New Zealand merely because it is incorporated or registered in New Zealand. Residency is determined by the residency tests, which do not apply to partnerships.

296. A partnership is not resident in New Zealand merely because it comes within the definition of "New Zealand partnership" in s YA 1 (discussed at [310]). This definition applies only for the purposes of the source rules to determine whether an amount has a source in New Zealand.

Residency of partners

297. Although partnerships do not have residency status, a partner of a partnership may have a residency status (unless it is also a partnership).

298. A partner's residency is determined by applying the normal residency rules to the partner having regard to their individual circumstances. The partner's residency is not determined by their capacity as a partner.[138]

299. A partner's residency can affect the partner's tax obligations and liabilities in their capacity as a partner. For example, a partner who is non-resident will only be liable for tax on income derived in their capacity as a partner if the income has a New Zealand source.

300. Although it is not a residency requirement for the limited partnership or even necessarily for the general partner (as noted at [10]), a limited partnership must have at least one general partner who satisfies the requirement in s 8(4) of the LPA. See s 8(4) of the LPA for more details.

Source

Source of amounts that partners receive

301. Given the transparent income tax treatment of partnerships, the source of an amount is generally relevant to the partners of a partnership, not to the partnership itself.

302. Partners are treated under s HG 2 as carrying on the business carried on by the partnership, as holding property that is held by the partnership and as doing a thing and being entitled to a thing that the partnership does or is entitled to in proportion to their partnership shares. This means that partners are treated as deriving income directly, in proportion to their partnership share of partnership income. These treatments mean an amount of income that a partner has by virtue of s HG 2 may have a source in New Zealand under the general source rules in s YD 4 (classes of income treated as having New Zealand source). In other words, the source of income for a partner is the same as the source the partnership would have if s HG 2 was ignored.

303. The amount of income a partner has from a particular source is calculated by multiplying the total income the partnership has from that source by the partner's partnership share in the partnership's income.[139]

304. Income derived from a business has a source in New Zealand if the business is:[140]
    - wholly carried on in New Zealand; or
    - partly carried on in New Zealand, to the extent to which the income is apportioned to New Zealand under s YD 5.

305. This income, in the hands of each partner, has a source in New Zealand for the purpose of determining each partner's assessable income. Income with a source in New Zealand may be included in a non-resident's assessable income, which may result in an income tax liability for the non-resident.

Source of amounts that a person receives from a partnership

306. A special source rule is provided in s YD 4(17B) for amounts that a person receives from a partnership. The rule in s YD 4(17B) works with other source rules in s YD 4 that are dependent on the payer of an amount being resident in New Zealand.[141]

138 However, a person's economic interests and business connections can be relevant factors in determining whether a person has a permanent place of abode, which is relevant for the residency of a natural person. See IS 16/03 Tax Residence (20 September 2016) *Tax Information Bulletin* Vol 28, No 10 (October 2016) taxtechnical.ird.govt.nz/interpretation-statements/is-1603-tax-residence

139 Section HG 2(2) (no streaming). See from [104].

140 Section YD 4(2).

141 Section YD 4(17B) was introduced in response to an issue identified by the Valabh Committee (the Consultative Committee on the Taxation of Income from Capital, appointed in 1989 and chaired by Arthur Valabh). The issue is discussed in General and limited partnerships – proposed tax changes (discussion document, Policy Advice Division, Inland Revenue, June 2006).

307. For example, the source rules in s YD 4 treat the following types of income, with some exceptions, as having a source in New Zealand:

- interest or a redemption payment derived from money lent outside New Zealand to a New Zealand resident;[142]
- a royalty payment made by a New Zealand resident;[143] and
- a payment for the use of personal property paid by a New Zealand resident.[144]

308. When a partnership includes only New Zealand partners it is clear that payments of interest, royalties and rents from a partnership have a New Zealand source. However, the question is how to deal with payments by New Zealand partnerships that include New Zealand and non-resident partners.

309. Section s YD 4(17B) partly addresses this question by treating all partners of a "New Zealand partnership" (discussed at [310]) as resident in New Zealand for the purposes of the source rules (even if some partners are non-resident). This will result in a payment being fully sourced in New Zealand with no apportionment required.

310. "New Zealand partnership" is defined in s YA 1. It means a partnership that:

- is a limited partnership registered under the LPA; or
- has 50% or more of its partners' interests in capital,[145] by value, held by New Zealand residents; or
- has its centre of management in New Zealand ignoring s HG 2.

Fixed establishments

311. A fixed establishment includes, among other things, a fixed place of business in which substantial business is carried on by a person.

312. Under s HG 2, the partners are treated as carrying on the business of the partnership and as holding property held by the partnership. If a partnership (ignoring transparency under s HG 2) has a fixed place of business in which substantial business is carried on by the partnership, then under s HG 2 the partners of the partnership will be treated as having a fixed establishment in New Zealand.

313. The same applies for a fixed establishment that is a branch, factory, shop or workshop in which, in each case, substantial business is carried on. Similarly, if the partnership has a mine, oil well, quarry or other place of natural resources subject to exploitation, the partners will be treated under s HG 2 as holding the rights held by the partnership and, therefore, will be treated as having a fixed establishment.

314. This applies to both general and limited partnerships. In the case of limited partnerships, limited partners can be treated as having a fixed establishment as outlined above.

315. Although the management role of the general partner in a limited partnership might seem relevant, the fact that the general partner is a New Zealand resident or the fact that the limited partnership has a registered office in New Zealand are not determinative of whether there is a fixed establishment. The registered office of the limited partnership would only be relevant if that was also a fixed place of business for the partnership and substantial business was carried on there by the limited partnership.

142 Section YD 4(11)(b)(i).

143 Section YD 4(9)(a).

144 Section YD 4(8)(a).

145 In the Commissioner's view, partners' interests in capital refers to the capital contributions of the partners.

Example | Tauira 13 – Fixed establishment

Limited partnership A is a limited partnership registered under the LPA.

The general partner of limited partnership A is a company incorporated in New Zealand, so is a New Zealand resident. The limited partnership has a registered office in New Zealand (the address of its law firm) but does not have any employees.

The limited partners of limited partnership A include non-residents.

Limited partnership A's only activity is making passive investments in a New Zealand stock portfolio from which it receives dividend income. Limited partnership A acquires management services as needed from a third-party investment manager in New Zealand. The directors of the general partner meet via video call to review and approve investment decisions presented by the limited partnership's investment manager. This does not involve any "substantial business" being carried on in New Zealand.

The limited partners are treated as carrying on the investment activity that is carried on by the limited partnership and as holding any investments that are held by the partnership. However, neither the partnership, nor the partners under s HG 2, are treated as having a fixed establishment in New Zealand.

The fact that the general partner is resident in New Zealand and that the limited partnership has a registered office in New Zealand do not create a fixed place of business for the partnership or the partners.

Permanent establishments

316. Where a partnership (general or limited partnership) has a permanent establishment in a contracting state, the partners are treated as also having a permanent establishment in that state. This is supported by *Commentary to the OECD Model Tax Convention to Partnerships*,[146] which discusses art 5 of the model tax convention (the permanent establishment article). It is also supported by *Application of the OECD Model Tax Convention to Partnerships*.[147]

Liability of partners as agents

General law

317. In the case of general partnerships, every partner of a general partnership is an agent of the partnership and the other partners for the purpose of the business of the partnership.[148] Partners are jointly liable for the debts and obligations of the partnership incurred while they are a partner.[149]

318. In the case of limited partnerships, a general partner is the agent of the limited partnership for the purposes of the business of the limited partnership.[150] The general partner is liable for unpaid debts and liabilities of the partnership incurred while they are a partner,[151] to the extent the partnership cannot pay those debts or liabilities.[152] Limited partners are not treated as agents for the partnership or the other partners and are not liable for the debts or liabilities, provided they do not take part in the management of the limited partnership.[153]

Tax debts

319. The general law described in [317] and [318] applies to a tax debt if the tax debt is a partnership debt. A partnership tax debt will arise, for example, if RWT or NRWT is withheld by a partnership. The partners of a general partnership or a general partner of a limited partnership may be liable for such a debt.

146 *Commentary to the OECD Model Tax Convention to Partnerships* (OECD, Paris, 1999) at [43] and [56].
147 *Application of the OECD Model Tax Convention to Partnerships* (OECD, Paris, 1999) at R(15)-26 [81].
148 Section 17 of the PLA.
149 Section 22 of the PLA.
150 Section 47 of the LPA.
151 Section 26 of the LPA.
152 Section 28 of the LPA.
153 Sections 31 and 46 of the LPA.

320. In relation to RWT, s RE 30(4) confirms that each partner of a general partnership is jointly and severally liable for the RWT that the general partnership is required to pay if the partner was a member of the partnership when the partnership incurred the RWT liability.[154]

Partner is generally not liable for another partner's income tax liability

321. A partner can be liable for partnership debt. However, partnership debt does not include an income tax liability of a partner on their share of partnership income. Therefore, subject to the rule relating to absentee partners discussed below, a partner is not liable for the income tax liability of another partner.

Debt write-offs and extinguishing losses

322. The Commissioner may write off outstanding tax that cannot be recovered. If the Commissioner writes off outstanding tax for a taxpayer who has a tax loss, generally the Commissioner must extinguish all or part of the taxpayer's tax loss.[155]

323. In the case of a partnership, outstanding tax could include income tax of a partner or a tax debt of the partnership that a partner is liable for.

324. Income tax is assessed to partners separately, so if the Commissioner writes off a particular partner's income tax debt, the Commissioner can only extinguish all or part of that partner's tax loss, not the tax losses of any other partner.

325. In the case of a tax debt of the partnership for which the partners are jointly and severally liable[156] (for example, PAYE), the amount of tax loss of a partner that can be written off is not limited to what would be a proportionate share of the tax debt based on their partnership share. If some partners do not have tax losses or if the tax losses of some partners are insufficient, the tax losses of the remaining partners can be extinguished up to the total amount of tax debt written off.

326. For more information, see **SPS 18/04 Options for relief from tax debt** at 13 to 15.

Absentee partners

327. Special rules apply in the case of absentee partners. This will be particularly relevant for many limited partnerships because limited partners are often non-resident foreign companies.

328. Under ss HD 3(2) and HD 20B, a partner may be liable for the income tax obligations of an absentee partner.

329. The following discusses the meaning of "absentee", when a partner is treated as an agent for an absentee partner, and the obligations of a partner if they are an agent for an absentee partner.

Meaning of "absentee"

330. "Absentee" is defined in s HD 18(2) for the purposes of subpart HD:

> *Meaning of absentee*
>
> (2) In this subpart, **absentee** means—
>
> (a) a natural person who is for the time being out of New Zealand:
>
> (b) a foreign company, unless it has a fixed and permanent place of business in New Zealand at which it carries on business in its own name:
>
> (c) a foreign company when the Commissioner declares that it is an absentee for the purposes of this Act by giving notice to the company, or its agent or representative in New Zealand.

331. Under this definition, a natural person is an absentee if they are "for the time being" out of New Zealand.

332. The Commissioner's view is that a person will be "for the time being" out of New Zealand if they are outside New Zealand at a time when an obligation is due to be performed. For example, a person will be "for the time being" out of New Zealand if they are outside New Zealand when they are due to file a return of income. This interpretation of the words "for the time being" is supported by the context of the agency rules, which requires an agent of an absentee to perform obligations.

154 This section applies only if the partnership has RWT-exempt status that relates to a taxable activity carried on by the partnership.

155 Section 177C(5).

156 This will generally only apply to partners of a general partnership or general partners of a limited partnership, not limited partners. Limited partners are not liable for limited partnership debt, provided they do not take part in the management of the limited partnership.

333. The Commissioner's view is that a person can be an "absentee" regardless of whether they have previously been in New Zealand. This is despite some senses in which the word is used (under the ordinary meaning) that suggest an absentee is a person who is not where they have been in the past.[157] "Absentee" is specifically defined in s HD 18(2). The definition in s HD 18(2) and the wider context do not indicate that absentee is used in the sense of a person who is not where they have been in the past.

334. A partner that is a foreign company will be an absentee unless it has a fixed and permanent place of business in New Zealand at which it carries on business "in its own name".

335. A "foreign company" is a company that is:[158]

- not resident in New Zealand; or
- treated under a double tax agreement as not being resident in New Zealand.

336. The requirement for a foreign company to carry on the business "in its own name" is significant because a partner can have a fixed and permanent establishment in New Zealand by being treated as carrying on the business that is carried on by the partnership in New Zealand. However, this business will be carried on in the name of the partnership, not in the name of the foreign company. The foreign company must carry on a separate business to satisfy this requirement.

337. The Commissioner can also declare a foreign company to be an absentee by giving notice to the company or its agent or representative in New Zealand. The Commissioner can do this whether or not the foreign company has a fixed and permanent place of business in New Zealand at which it carries on business "in its own name".[159]

When a partner will be treated as an agent of an absentee partner

338. Under s HD 20B, a partner of a general partnership or a general partner of a limited partnership may be treated as an agent of an absentee partner. Limited partners are not treated as agents of absentee partners.

339. Under s HD 20B, a partner of a general partnership is treated as agent of an absentee if the partner carries on a business in New Zealand in a partnership. Under s HG 2, partners are treated as carrying on a business in New Zealand if the partnership carries on business in New Zealand. This means a partner of a general partnership is treated as an agent of an absentee even if they do not have an active role in the partnership.

340. Under s HD 20B, a general partner of a limited partnership is treated as an agent of an absentee if the limited partnership carries on business in New Zealand.

Obligations of an agent for an absentee partner

341. If a partner is treated as an agent for an absentee partner, the agent partner must meet the following tax obligations in relation to the absentee's share of the partnership's income:[160]

- make the assessments that the absentee partner is required to make;
- provide all returns required of the absentee partner under the TAA; and
- satisfy the absentee partner's income tax liability.

342. In making the assessments, an agent can also claim, in relation to the agency income, deductions, tax credits, or exemptions to which the absentee partner is entitled. An agent for an absentee is treated in that agency capacity as a separate person. An agent must not claim, in relation to the agency income, deductions, tax credits or exemptions that the agent has in their own capacity.[161]

343. The agent partner and the absentee partner are jointly and severally liable for the tax obligations relating to the agency.[162]

344. If two or more partners are liable as agents in relation to an absentee's tax liability, the liability is joint and several.[163]

157 *Shorter Oxford English Dictionary* (6th ed, 2007, Oxford University Press).
158 Under s YA 1.
159 Section HD 18(2)(c).
160 Sections HD 3(2) and HD 18(1).
161 Section HD 3(4).
162 Section HD 2.
163 Section HD 3(3).

Application of land rules to partnerships

Introduction

345. It is useful to discuss, as an example, the application of s CB 9 in the land rules to partnerships. This discussion is useful because it combines aspects of the transparent tax treatment of partnerships and the application of the associated person and safe harbour rules.

346. As noted at [30], s HG 2 results in income being derived directly by the partners of a partnership, not the partnership. Generally, provisions in the ITA such as s CB 9 that include an amount in a person's income, or allow a person a deduction for an expenditure or loss, apply to the partners of a partnership, not the partnership.

Section CB 9 – business of dealing in land

Section CB 9(1) – person in the business of dealing in land

347. Under s CB 9(1) an amount a person derives from disposing of land is included in the income of the person if:
    - they dispose of the land within 10 years of acquiring it; and
    - at the time they acquired the land, they carried on a business of dealing in land, whether or not the land was acquired for the purpose of the business.

348. If a person has income under s CB 9(1), they may be allowed a deduction for the cost of the property under s DA 1 (general permission) and s DB 23 (cost of revenue account property).

349. In applying ss CB 9(1) and the deduction provisions above, it is relevant to consider:
    - whether there has been a disposal of land;
    - when the person acquired the land and when the 10-year period begins;
    - the cost of the land when the person acquired it; and
    - whether the person carried on a business of dealing in land at the time they acquired the land.

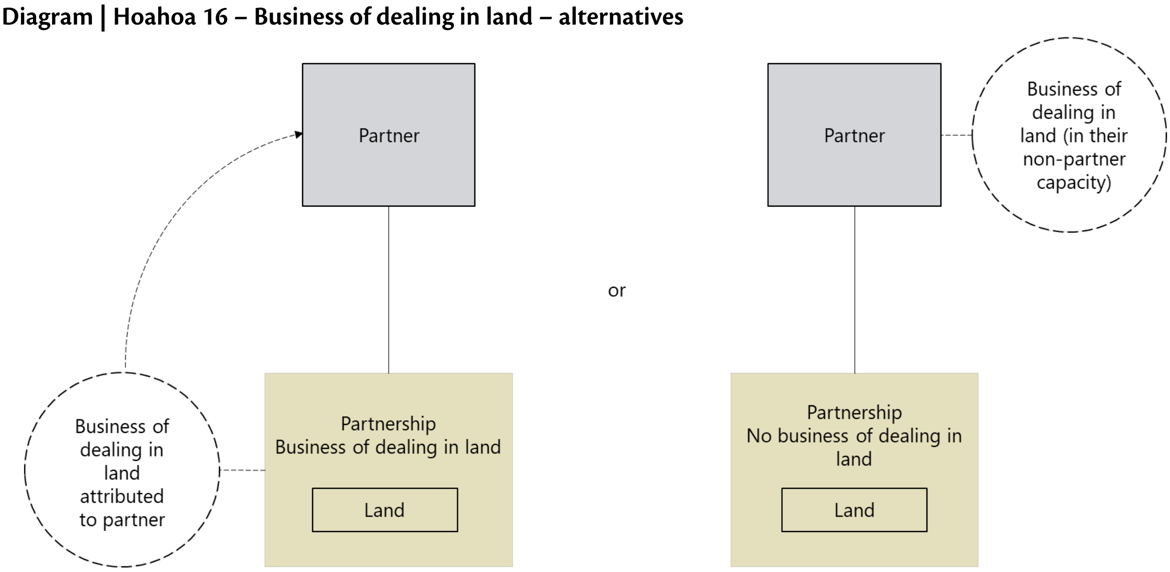
Disposal of land

350. In the partnership context, a disposal may arise where the partnership disposes of the land or where there is a deemed disposal of the land on the exit of a partner or on the final dissolution of the partnership where the partnership's business will not continue to be carried on in partnership.

Business of dealing in land

351. The requirement to have carried on a business of dealing in land could be satisfied if:
    - the partner carried on such a business separately from the partnership; or
    - the partnership carried on a business of dealing in land.

Diagram | Hoahoa 16 – Business of dealing in land – alternatives



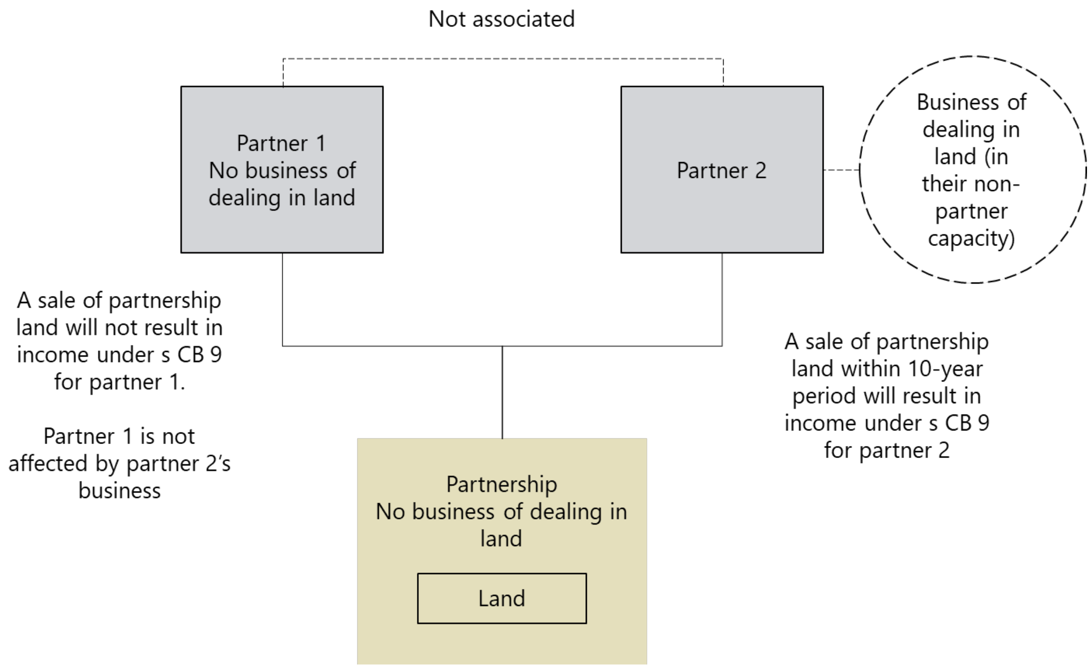
Partner with a separate business of dealing in land

352. If a partner carries on a separate business of dealing in land and partnership land is disposed of within the 10-year period, the partner's share of the proceeds from the disposal of the partnership land will be included in the partner's income under s CB 9(1).[164] The fact the partnership (and, by virtue of s HG 2, the partner) acquired the land for a purpose unrelated to the partner's separate business, does not prevent s CB 9(1) from applying. This is because s CB 9(1) applies "whether or not the land was acquired for the purpose of the business".

353. The partner's separate business of dealing in land would not affect the other partners' share of the proceeds from a disposal of partnership land unless they were associated with the partner, for example under s YB 4. Two partners are not associated merely by being partners in the same partnership (see [263]).

354. This is illustrated in Diagram | Hoahoa 17.

Diagram | Hoahoa 17 – Partner with separate business of dealing in land



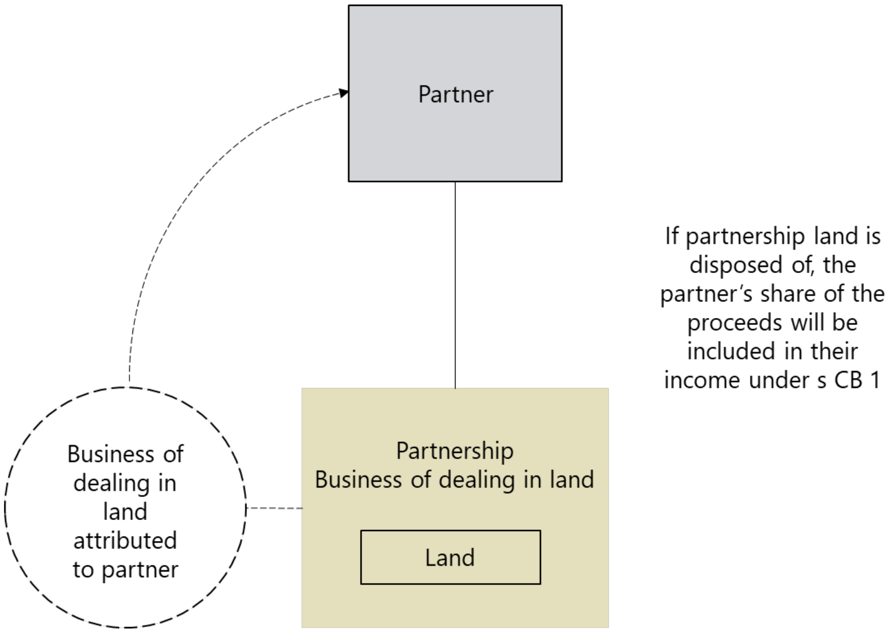
Partnership carries on a business of dealing in land

355. If a partnership carries on a business of dealing in land, then by virtue of s HG 2 the partners are treated as carrying on that business, but only for the purposes of the partner's liabilities under the ITA in their capacity as partner (see [55]).

356. This means that, for example, if the partnership disposes of partnership land within the 10-year period, the partner's share of the proceeds of the disposal will be included in the partner's income. This would be included in income under ss CB 1 (Amount derived from business); it would not be necessary to rely on s CB 9 (or even s CB 7 (Disposal: land acquired for purposes of business relating to land)).

164 The taxation of amounts that a person has as a partner can be affected by the person's own characteristics and non-partnership activities. See [48].

Diagram | Hoahoa 18 – Partnership in business of dealing in land



357. Under s CB 9(1), a partner would not be treated as carrying on the business of dealing in land carried on by the partnership where the partner disposes of land that they hold in their non-partner capacity. This is because the treatment under s HG 2 only applies in the partner's capacity as partner. However, the proceeds of the disposal could be income under s CB 9(2) if the partner is associated with the partnership, which is carrying on the business of dealing in land (s CB 9(2) is discussed from [370]).

Cost base and timing

358. Where the partners have changed since the partnership acquired the land, it is necessary to consider whether the safe harbour rules apply.

359. The application of s CB 9 is considered below in three scenarios involving a disposal by an original partner and a disposal by a new partner where the safe harbour rules apply and where the safe harbour rules do not apply. The safe harbour rules are discussed from [181].

Original partner

360. A partner might have been a partner at the time the partnership acquired the land. If so, they would have acquired an interest in the land on the date the partnership acquired the land. This is the date from which the 10-year period starts and the date on which the partner must have carried on a business of dealing in land.

361. If the partnership carried on a business of dealing in land on this date, then by virtue of s HG 2 the partner is treated as having carried on the business on that date.

362. The requirement to have carried on a business of dealing in land could also be satisfied if the partner carried on such a business separately from the partnership on the date the partnership acquired the land.

363. For deduction purposes, the partner's cost for the land will be their share (based on the partner's partnership share in the partnership's income) of the cost of the land to the partnership.

Entering partner where the safe harbour rule applied to the acquisition of the partnership interest

364. A partner (an entering partner) may have acquired their partnership share after the partnership acquired the land. In that case, if the safe harbour rule in s HG 5 applies, an entering partner is treated as if they had originally acquired and held the interest in the land. Further, the partner or partners (the exiting partner) from whom the entering partner acquired the partnership interest are treated as not having acquired and held the interest.

365. The 10-year period starts from the date the exiting partner acquired the interest in the land.

366. The entering partner takes on the cost base of the exiting partner.

367. The question of whether the entering partner carries on a business of dealing in land is determined as at the date the entering partner acquires their partnership share. The Commissioner considers the date on which this question is determined is not affected by s HG 5 as it is outside the intended scope of the fiction created by that section. This is because the business of dealing in land is a special characteristic that is particular to the entering partner. Parliament is unlikely to have intended this to be tested based on the exiting partner's timing, particularly given that the entering partner may not yet have existed.

Entering partner where the safe harbour rule did not apply to the acquisition of the partnership interest

368. If the safe harbour rule did not apply to the acquisition of the partnership share, the entering partner acquires the interest in the land on the date they acquire the partnership share. This is the date from which the 10-year period starts and the date for the determination of whether they carried on a business of dealing in land.

369. The entering partner's cost is the portion of the consideration paid for the partnership share allocated to the land.

Section CB 9(2) – person associated with a person in the business of dealing in land

370. Under s CB 9(2) an amount is included in the income of a person (person A) if:

- person A derives an amount from disposing of land within 10 years of acquiring the land; and
- at the time they acquired the land, person A was associated with another person (person B) who carried on a business of dealing in land.

371. For the avoidance of doubt, s CB 9(2) applies whether or not:

- person A carried on a business of dealing in land; or
- the land was acquired for the purpose of person B's business.

Role of person A in s CB 9(2) in the context of a partnership

372. In the context of a partnership, person A referred to in s CB 9(2) (the person who may have income under s CB 9(2)) could be a partner in the partnership or could be a person associated with a partner. Person B (the person who carries on the business of dealing in land) could be a person who carries on the business separately from any partnership, or person B could be a partnership[165] that carries on such a business. Both scenarios are discussed below.

Person A as a partner

Disposal of land held by person A in their non-partner capacity

373. An amount a partner (person A) of a partnership derives from the disposal of land they hold in their non-partner capacity can be income under s CB 9(2) if the land is disposed of within the 10-year period and, at the time the land was acquired:

- the partnership (person B) carried on a business of dealing in land;[166] and
- the partner was associated with the partnership.

374. In the case of a limited partnership, a limited partner will only be associated with the partnership if the limited partner has a partnership share of 25% or more.[167] Therefore, a limited partner with a lower partnership share will not have income under s CB 9(2) in this scenario.

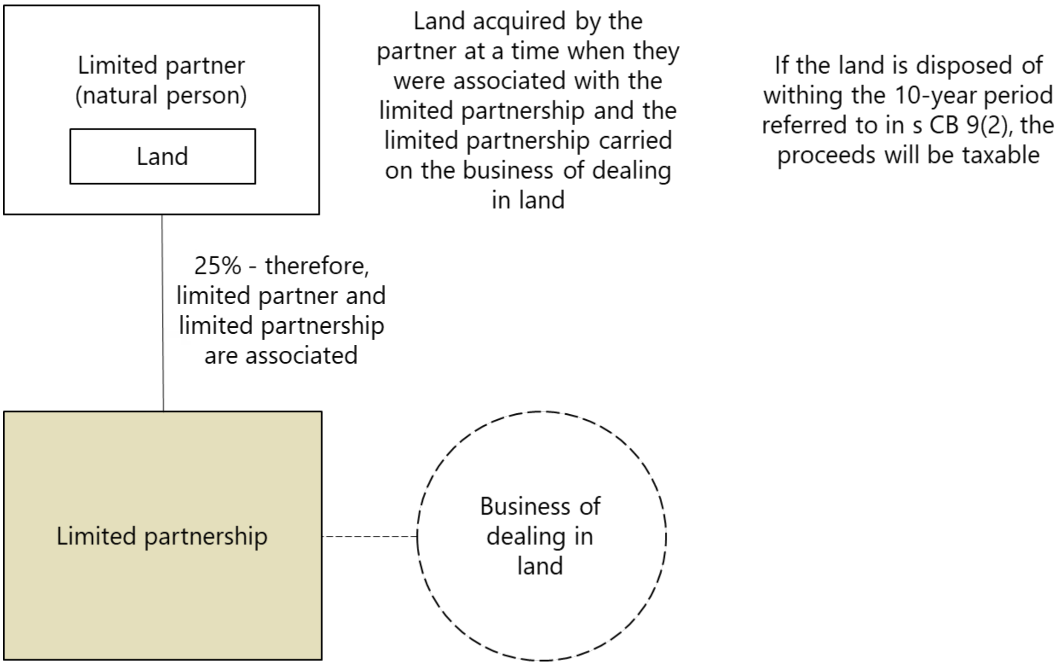
375. This is illustrated in Diagram | Hoahoa 19.

165 As discussed further at [382], in this scenario, person B would be the partnership, not a partner, because the transparent tax treatment of partnerships would not apply.

166 The partnership is treated as carrying on the business because s CB 9 is being applied to person A in relation to the disposal of land they hold in their non-partner capacity. Section HG 2 only applies for the purposes of a partner's liabilities and obligations in their partner capacity.

167 Assuming s YB 16B does not apply.

Diagram | Hoahoa 19 – Person A as partner, land held in non-partner capacity



Disposal of partnership land

376. When s CB 9(2) is applied to land owned by a partnership that is not in the business of dealing in land,[168] the question will be whether a partner (person A) was, at the time the land was acquired, associated with a person (person B) who carried on a business of dealing in land.

377. Person B could be a:

- person unrelated to the partnership, for example the person may be associated with the partner (person A) as a relative[169] (this is illustrated in Example | Tauira 14); or
- company in which the partnership holds shares if the partner (person A) is associated with the company through the partnership, under either the tripartite relationship test or an aggregation test.

168 If the partnership is in the business of dealing in land, then person A would also be treated under s HG 2 as being in the business of dealing in land. Therefore, s CB 9(1), rather than s CB 9(2), would apply to person A without any need for association.

169 For the purposes of the land rules (including s CB 9(2)), two people are associated as relatives if they are married, in a civil union or in a de facto relationship (s YB 4(1)(b)). Two people are associated as relatives because of a blood relationship only if one is the infant child of the other (s YB 4(2)).

378. This is illustrated in Diagram | Hoahoa 20 and Diagram | Hoahoa 21.

Diagram | Hoahoa 20 – Person A as a partner, person B non-partner

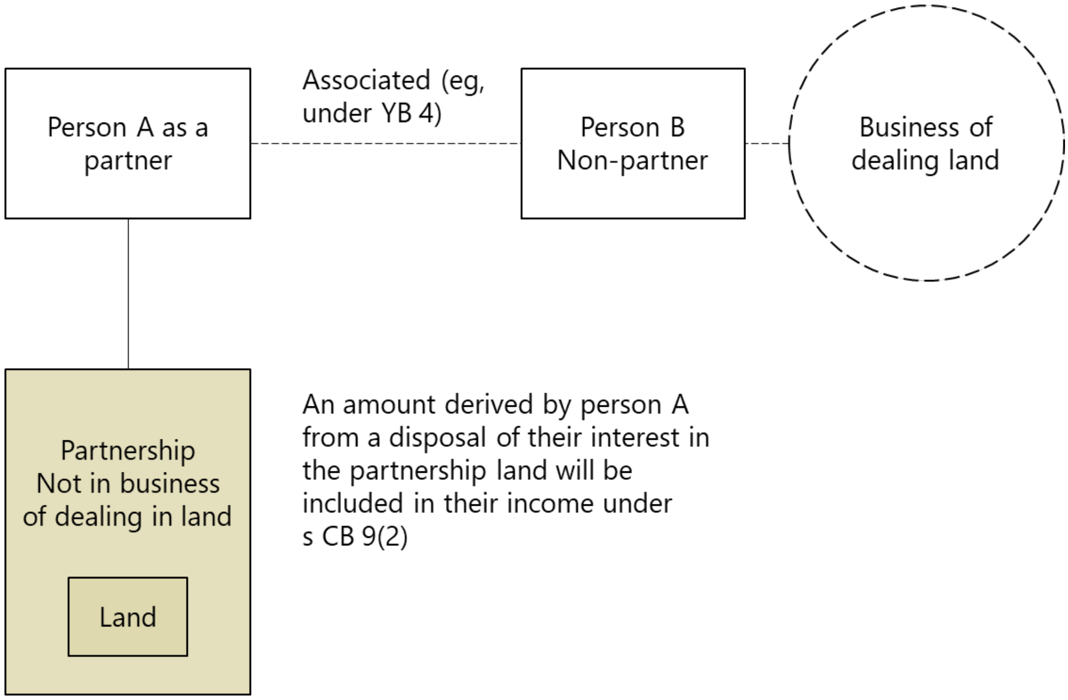
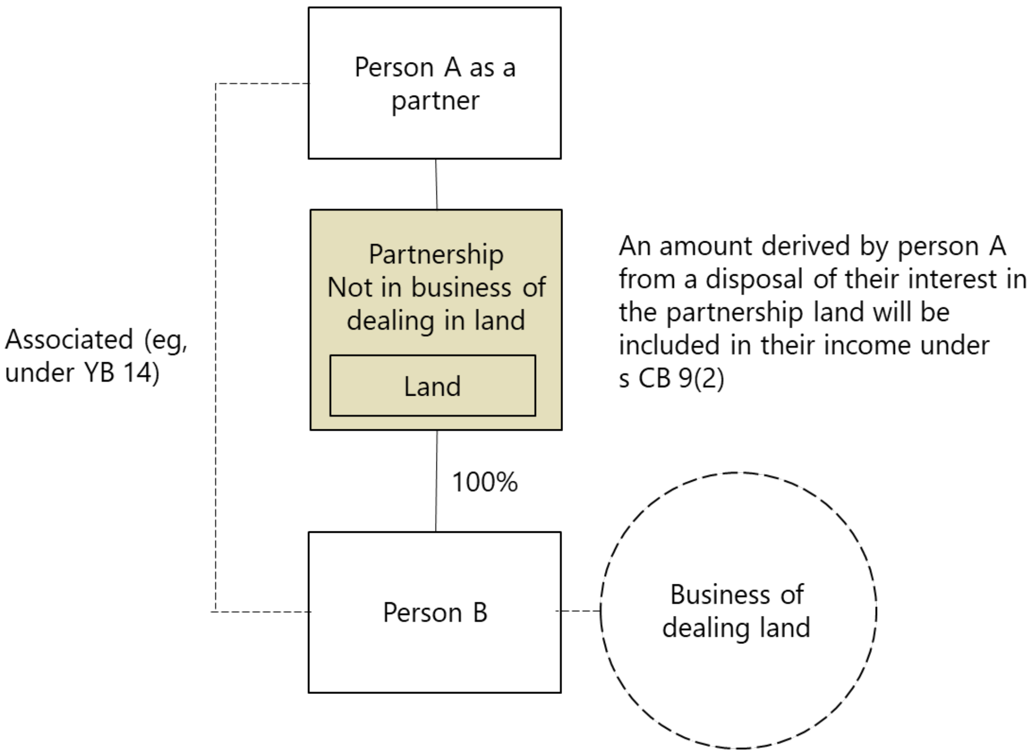


Diagram | Hoahoa 21 – Person A as partner, person B company owned by partnership



379. Section CB 9(2) does not necessarily apply where person B is another partner who, in their separate capacity, is in the business of dealing in land. This is for two reasons:

- Partners are not associated merely because they are partners of the same partnership. The tripartite relationship test does not associate two partners merely because they are partners. The answer would be different if the partners were associated under a different test (for example, under s YB 4 (two relatives)).
- The fact the partnership may be associated with person B (who is in the business of dealing in land) is not relevant to the application of s CB 9(2) to partner A. Person A themselves must be associated with the person who is carrying on the business. This is because s CB 9(2) is applied to partner A, not the partnership.

380. This is illustrated in Diagram | Hoahoa 17 (above), and in Example | Tauira 14 and Example | Tauira 15.

Example | Tauira 14 – Partner associated with a dealer

Facts

Person A is a partner in a partnership.

The partnership sells land that it held on capital account. The partnership held the land for 7 years.

Person A was a partner of the partnership when the partnership acquired the land. On the date the partnership acquired the land, person A's de facto partner, person B, carried on a business of dealing in land. However, the land was not acquired for the purpose of person B's business.

Tax treatment

Section CB 9(2) applies to include person A's partnership share of the sale proceeds in his income.

Section CB 9(2) applies despite the land not being acquired for the purpose of person B's business.

Example | Tauira 15 – Where another partner carries on a business of dealing in land

Facts

A partnership carries on a business of providing residential accommodation, so holds residential properties on capital account. The partnership has two partners, persons A and B.

Person B carries on another business in her own name involving buying and selling residential properties.

The partnership sells one of its properties and makes a gain on sale.

Tax treatment

Person A does not carry on a business in dealing in land and is not associated with person B, so person A's share of the sale proceeds is not included in person A's income under s CB 9(2).

Section CB 9(1) applies to include person B's share of the sale proceeds in person B's income.

For person B, the tax treatment of the sale of the partnership property is affected by the nature of the business that person B carries on in her own name. Section CB 9(1) applies whether or not the land was acquired for the purpose of the business of dealing in land.

Person A as a non-partner

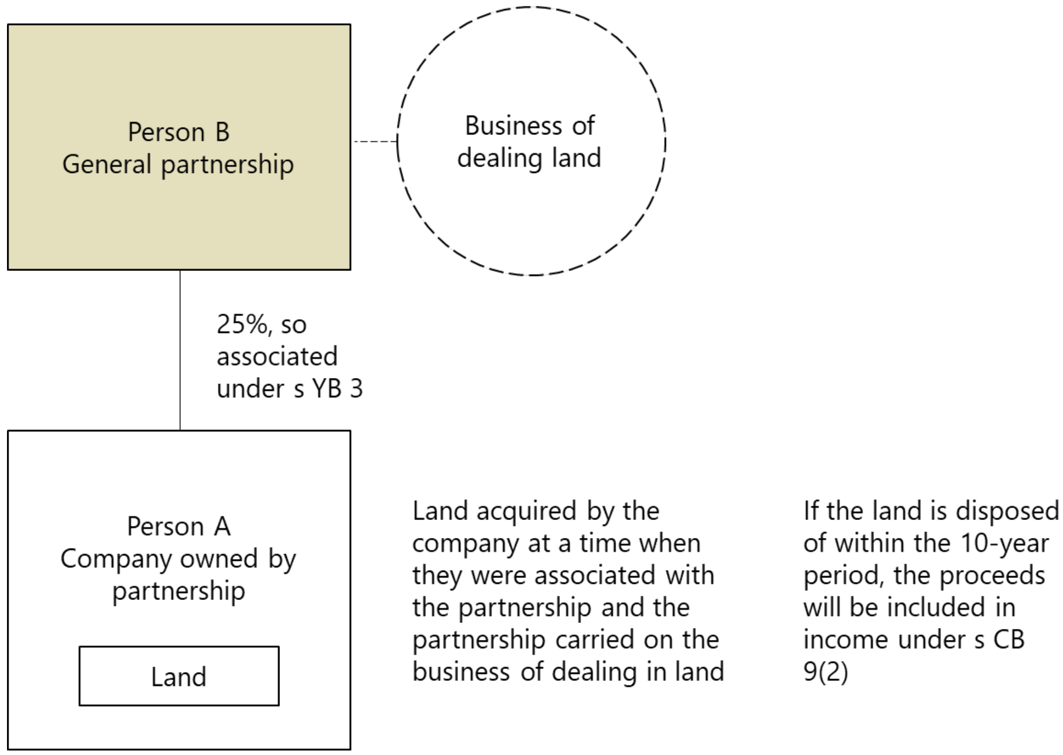
381. Section CB 9(2) could apply to include an amount in the income of a non-partner (person A) if they are associated, under the tripartite relationship test or an aggregation test, with a partnership[170] (person B) carrying on a business of dealing in land.

382. Person A (the non-partner to whom s CB 9(2) is being applied) may be associated with a general partnership (person B) if person A is a company and the partnership has voting or market value interests of 25% or more in person A. Alternatively, person A may be associated with the partnership under the tripartite relationship test or an aggregation test, through an association with a partner of the partnership.

383. In this scenario (where person A is a non-partner), person B is necessarily a partnership and not a partner. The transparent tax treatment of partnerships under s HG 2 applies only for the purposes of determining a partner's liabilities and obligations under the ITA. In this scenario, s CB 9(2) is being considered in relation to person A, who is a non-partner, so s HG 2 does not apply. In the absence of s HG 2 applying, the partnership is regarded as carrying on the business, so the relevant association in this scenario is with the partnership.

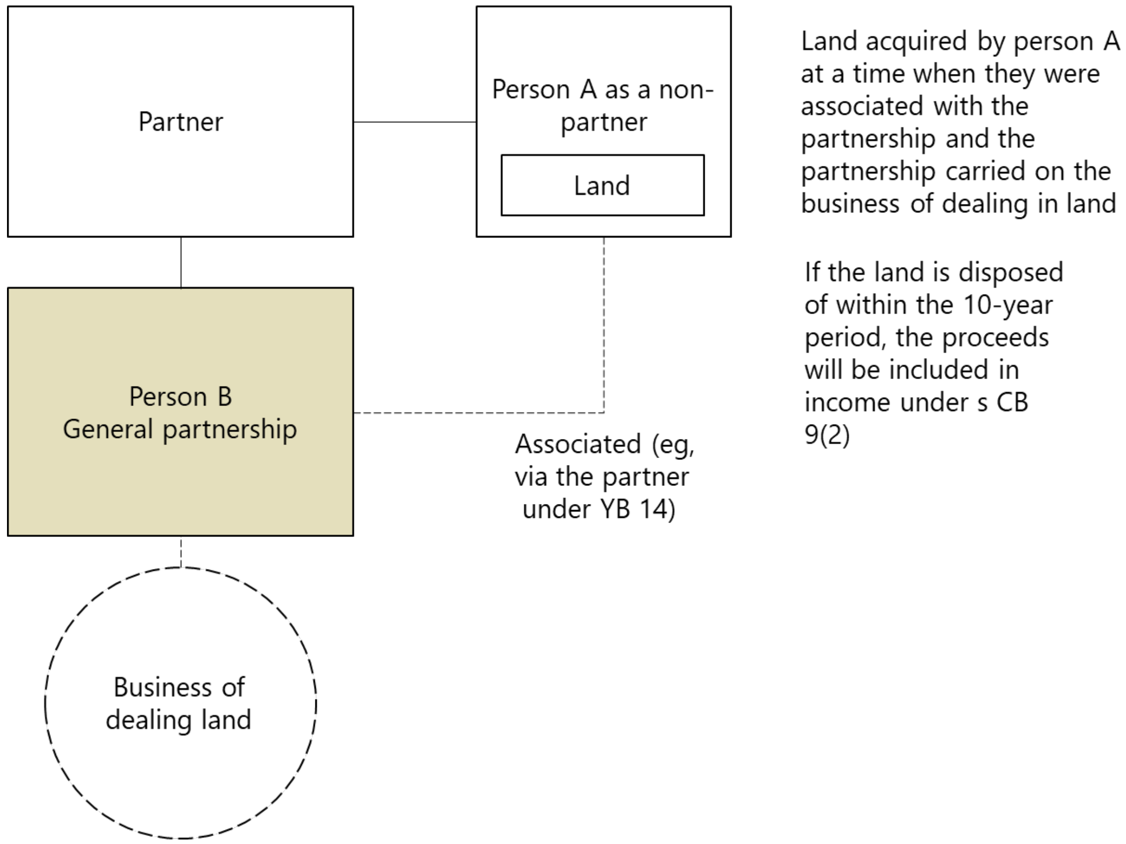
384. This is illustrated in Diagram | Hoahoa 22 and Diagram | Hoahoa 23 and in Example | Tauira 16.

Diagram | Hoahoa 22 – Person A as a non-partner, company owned by partnership



170 Not a partner. See [382].

Diagram | Hoahoa 23 – Person A as a non-partner, associated with partnership



Example | Tauira 16 - Application of s CB 9(2) to a non-partner associated with a partnership

Facts

Person 1 derives an amount from the sale of land held in her name.

The land was sold within 10 years of acquisition.

On the date person 1 acquired the land:

- she was in a de facto relationship with person 2;
- person 2 was a partner of general partnership A; and
- general partnership A carried on a business of dealing in land.

Tax treatment

The amount person 1 derives from the sale of the land is included in person 1's income under s CB 9(2). This is because on the date she acquired the land, person 1 was associated with general partnership A (under the tripartite relationship test, through her de facto relationship with person 2), and general partnership A was in the business of dealing in land.

Application of s HG 5

385. The application of s HG 5 to a partner who may be subject to s CB 9(2) raises similar questions to those raised for s CB 9(1).

386. If the partner was a partner at the time the partnership acquired the land, the question of whether the partner was associated with a person who carried on a business of dealing in land is determined as at the date the partnership acquired the land.[171]

171 To be clear, the parties need to be associated on this date and the business needs to be carried on on this date.

387. In the case of an entering partner, and whether or not the safe harbour rules applied to the acquisition, the question of whether the partner was associated with a person who carried on a business of dealing in land should be determined as at the date the entering partner acquired their interest in the partnership. The Commissioner considers that the date on which this question is determined is not affected by s HG 5 as it is outside the intended scope of the fiction created by that section. This is because the association with a person in the business of dealing in land is a special characteristic that is particular to the entering partner. Parliament is unlikely to have intended this to be tested based on the exiting partner's timing, particularly given that the entering partner or associated person may not yet have existed.

Foreign investment fund rules apply at the partner level

388. The foreign investment fund (FIF) rules apply to the partners of a partnership, not the partnership. This is a useful illustration of the transparency of partnerships in the ITA.

389. It is outside of the scope of this statement to discuss the FIF rules in any detail. However, in response to questions that have been raised in the past, the following discusses how two thresholds in the FIF rules are applied in the case of shares owned by a partnership. The two thresholds are relevant in the following situations:

- A natural person may have no FIF income where the total cost of all FIFs that the person held at any time during the income year was $50,000 or less.[172]
- A person may have no FIF income if the person has an income interest of 10% or more in a FIF that is a controlled foreign company (CFC).[173]

390. There are further details associated with these thresholds that would need to be considered by anyone subject to them. The focus here is on determining whether the thresholds are met where shares are owned by a partnership, given the transparent tax treatment of partnerships.

391. In both cases, in the context of a partnership, the persons referred to will be partners of a partnership who, because of s HG 2, holds a share of a FIF.

392. For the $50,000 threshold, a partner may satisfy the $50,000 threshold if the partner's cost base for the FIF is $50,000 or less. This cost base is calculated based on the partner's partnership share. For example, if a partnership purchases shares for $90,000 and a partner has a one-third partnership share in the assets of the partnership, the partner has a cost base of $30,000 for the shares.[174]

393. The partner's cost base may arise from being a partner at the time the FIF is acquired or by acquiring a partnership share. The partner's cost base for a FIF that is acquired as a result of acquiring a partnership share depends on whether the safe harbour rules apply.

394. For the 10% threshold, a partner may satisfy the threshold if the person has an income interest of 10% or more in a CFC. This income interest is calculated based on the partner's partnership share in the partnership's income. For example, if a partnership holds 30% of the shares in a CFC and a partner has a 40% partnership share in the partnership's income, the partner has an 12% income interest in the CFC.

172 Section CQ 5(1)(d)(i). Where the total cost of attributing interests in FIFs that the person held at any time during the income year was $50,000 or less, the person could nevertheless choose to have FIF income by including the FIF income in a return for the year (s CQ 5(1)(d)(ii)).

173 Sections CQ 5(1)(c)(iv) and EX 34.

174 This is consistent with the comments in *Tax Information Bulletin* Vol 19, No 3 (April 2007): 31 regarding the application of the $50,000 FIF exemption threshold in the case of a married couple or a couple in a de facto relationship or civil union. Such a couple could together hold shares costing $100,000 if half of the shares were held in each partner's name or if they owned the shares jointly.

395. This is illustrated in Example | Tauira 17.

Example | Tauira 17 – FIF rules apply at the level of the partners

Facts

Partnership A has three New Zealand resident partners, partners 1 to 3. Each partner has a one-third partnership share in the partnership's income.

Partnership A holds 27% of the shares in Overseas Company Ltd, which is a CFC. Partnership A purchased the shares for NZ$120,000. Partners 1 to 3 were partners at the time the shares were purchased and there has not been in any change in the partners' interests since.

Partner 3 also holds 1% of the shares in Overseas Company Ltd in their own name. The remaining 78% of shares are owned by another person who is also New Zealand resident.

On 1 April 2022, at the beginning of the 2023 income year, Overseas Company Ltd had net assets of NZ$300,000.

During the 2023 income year Overseas Company Ltd paid a NZ$30,000 dividend to the partnership.

Partner 1

Partner 1 is a natural person. Partner 1 does not hold shares in Overseas Company Ltd in their own name, nor does partner 1 hold any other interests in overseas companies or other investments classified as a FIF.

Partner 1's total attributing interests in FIFs is NZ$40,000, being their onethird share of the $120,000 cost of the shares.[175] This is not more than $50,000, so partner 1 qualifies for the FIF exemption.

Partner 1 does not have to use this exemption – they could choose to return FIF income in their return for the income year. If partner 1 does not return FIF income, they will instead have dividend income of $10,000 (one-third of the $30,000 dividend).

Partner 2

Partner 2 is a natural person. Partner 2 has shares in another overseas company that is classified as an attributing interest in a FIF. These other shares cost $20,000.

Partner 2's total attributing interests in FIFs is $60,000 ($40,000 + $20,000). Therefore, partner 2 does not qualify for an exemption from the FIF rules and will have FIF income.

Partner 3

Under s HG 2, each partner is treated as having a 9% interest in Overseas Company Ltd through the partnership (onethird of 27%).

Partner 3, in addition, holds a 1% shareholding in Overseas Company Ltd in their own name. This means that partner 3 has an income interest of 10% or more, so is subject to the CFC rules rather than the FIF rules.

Thin capitalisation rules apply at the partner level

396. The thin capitalisation rules in subpart FE limit the effective level of interest deductions that a taxpayer can claim (by treating the taxpayer as deriving income if the interest deductions exceed a certain level). It is outside of the scope of this statement to discuss the thin capitalisation rules in any detail.

397. The transparency of partnerships applies for the purposes of a partner's liabilities and obligations under the Act in their capacity of partner of a partnership unless the context otherwise requires. The thin capitalisation rules do not contain any specific rule for partnerships or any indication that transparency should not apply. To the contrary, the thin capitalisation rules include residency requirements that would be difficult to apply to a partnership as opposed to a partner. Therefore, the Commissioner's view is that the thin capitalisation rules apply at the partner level.

175 This assumes that the interest is not exempted from being an attributing interest, for example by being an ASX-listed Australian company.

398. When applying the thin capitalisation rules, it is necessary to determine a person' debt percentage. If a person is a partner of a partnership, the calculation of the person's debt percentage will involve their share of amounts borrowed by the partnership, as well as their share of the partnership's assets. Other borrowings and assets held by a partner in different capacities may also form part of the calculation of the partner's debt percentage.

Deduction limitation rule for limited partnerships

Introduction

399. The section applies only to limited partnerships.

400. Section HG 11 imposes a limit on the amount of deductions a limited partner can claim in an income year as a partner of a limited partnership.[176]

401. The purpose of the limitation is to discourage loss trading. Without a deduction limitation rule, investors could enter arrangements whereby small amounts of capital are invested to get access to larger tax losses.[177]

402. The deduction limitation rules ensure limited partners can offset tax losses only to the extent the tax losses reflect the partners' economic investment – the amount that they have at risk. The economic amount a partner has at risk is represented in the "partner's basis" amount defined in s HG 11. The partner's basis includes equity invested and withdrawn, capital gains and losses, income, expenditure and loss amounts, and a partner's exposure to risk.

403. This limitation on deductions is aimed mainly at limited partners because general partners have unlimited liability, so full exposure to the risk of loss.[178]

404. Deductions that are denied in an income year by the deduction limitation rule can be carried forward to the following income year.[179] However, deductions cannot be carried forward to an income year if, in the income year, the limited partner ceases to be a partner or the limited partnership ceases to be a limited partnership.[180] Also, deductions carried forward by an exiting partner are not transferred to an entering partner who acquires the partnership interests of the exiting partner.[181]

Limitation applies only if the partner has a loss from the partnership

405. As noted above, s HG 11 applies in an income year only if the partner has a loss from the partnership for that year.[182] That is, the partner's "limited partnership deduction" (s YA 1) for the income year must be more than the partner's assessable income from the partnership for the income year. If the limited partnership deduction is equal to or less than the assessable income, then a full deduction is allowed.

406. The limited partnership deduction for a partner and an income year includes the deductions the partner would have in the income year as a result of s HG 2 as a partner in the partnership plus any limited partnership deductions denied in the previous income year under s HG 12. This is illustrated in Diagram | Hoahoa 24.

176 This limitation is sometimes referred to as the loss limitation rule. This is because s HG 11 applies only if the partner has a loss from the partnership and, by limiting a partner's deductions, s HG 11 has the effect of limiting the loss the partner has from the partnership. However, despite the name and this effect, the limitation calculation is focused on the partner's deductions.

177 The rationale was discussed in the discussion document that led to the partnership rules, General and limited partnerships – proposed tax changes – a government discussion document (Policy Advice Division, Inland Revenue, 2006) at [8.2]. https://www.taxpolicy.ird.govt.nz/publications/2006/2006-dd-limited-partnerships.

178 However, s HG 11(1)(b) contains a rule to prevent a partner avoiding the deduction limitation for an income year by becoming a general partner for the income year.

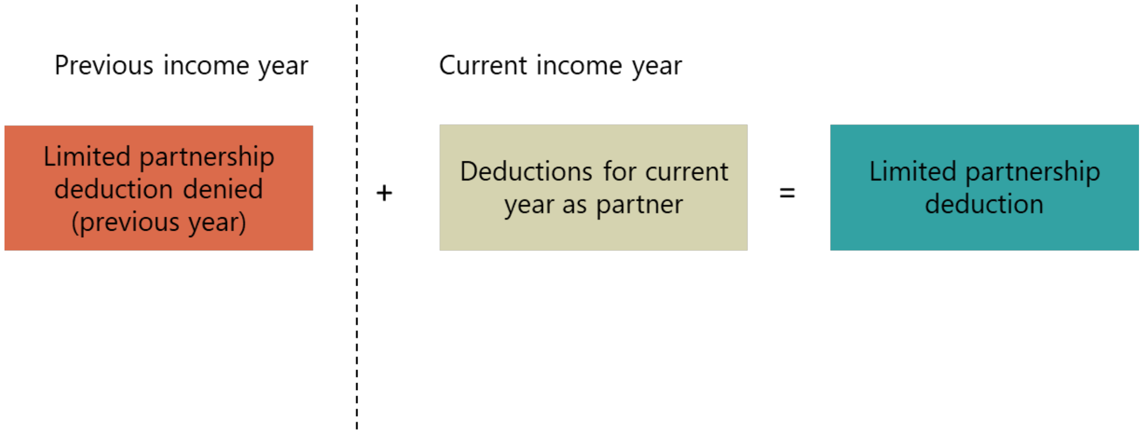
179 Section HG 12.

180 Section HG 12(2).

181 Section HG 12 would apply only to an exiting partner who was denied the deduction. Even if the safe harbour rule in s HG 5 applies, and the entering partner is treated as having originally acquired and held the current interests, this does not apply to a deduction carried forward under s HG 12.

182 The deduction denied is the lesser of the amounts given by s HG 11(2)(a) and (b). If there is no loss, the amount given by s HG 11(2)(b) will be zero. The amount given by s HG 11(2)(a) can only be positive or zero. Therefore, if there is no loss then the deduction denied will be zero.

Diagram | Hoahoa 24- Limited partner deduction definition



Whether the limited partnership deductions are more than the "partner's basis"

407. If a partner does have a loss from the partnership, the next question is whether the limited partnership deductions are more than the "partner's basis". The partner's basis is a measure of a partner's economic investment in a partnership. The calculation of this amount is discussed from [411].

408. If the limited partnership deductions are equal to or less than the partner's basis, then a full deduction is allowed.

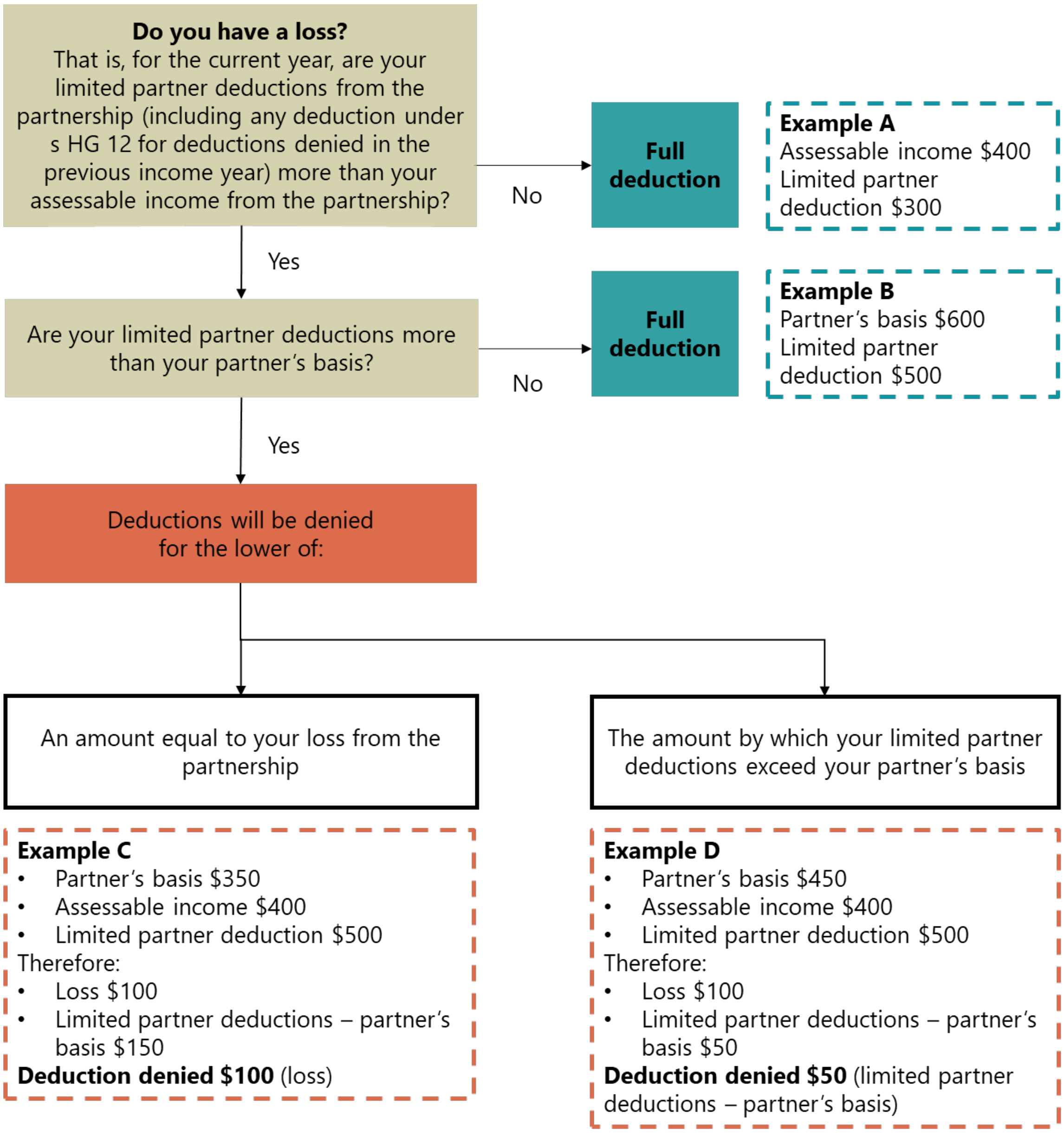
Deduction amount that is denied

409. If the limited partnership deductions are more than the partner's basis, then the limited partnership deductions amount that is denied for the income year is equal to the lower of the:

- difference between the partner's basis and the limited partnership deductions; and
- loss from the partnership.

410. This is illustrated, with examples, in Diagram | Hoahoa 25.

Diagram | Hoahoa 25 - Limitation calculation



Partner's basis

411. The "partner's basis" is a measure of a partner's economic investment in a limited partnership, including equity invested and withdrawn, capital gains and losses, income, expenditure and loss amounts, and exposure to risk.

412. The definition includes five main amounts:[183]

- investment;
- distributions;
- income;
- deductions; and
- disallowed amount.

183 These terms have specific meanings in this context. For example, "income" does not have its usual meaning.

413. Each amount has components that are summarised below along with examples.

414. The partner's basis is found by subtracting the distributions, deductions and disallowed amounts from the total of the investments and income amounts.

415. The partner's basis is calculated on the last day of the income year.[184]

Investments

416. The "investments" amount comprises three components:

- "capital contributions" the partner made to the partnership;
- the amount paid by the partner as an entering partner for the assignment of an interest in partnership property to them; and
- "secured amounts" to the extent to which secured amounts are not already included in the investments amount as capital contributions in the form of loans made to the partnership by other partners.

Capital contributions the partner made to the partnership

417. The investments amount includes the market value of capital contributions the partner made to the partnership. The market value is measured at the time the partner contributed or agreed to contribute the relevant contribution.

418. Capital contribution is defined for the purposes of s HG 11.[185] The definition includes a capital contribution as defined in the LPA. Under s 37 of the LPA, the capital contribution of a partner is defined as the share of the assets contributed, or agreed to be contributed, by a partner to the limited partnership or assigned to a partner under s 38(2) of the LPA.

419. The definition in the LPA suggests a capital contribution is linked to the asset or the share in the asset that is contributed to the partnership. However, a capital contribution is more accurately described as a nominal amount that arises for a partner equal to the value of the asset that is contributed. If the capital contribution was the asset itself, then the capital contribution would cease to exist if the asset was disposed of or converted into something else. This seems unlikely to have been what Parliament intended. For example, consider the case where partner 1 contributes land valued at $100,000 to a limited partnership, the land is immediately sold, and the proceeds are used to purchase trading stock. Partner 1 would still have $100,000 of capital contributions.

420. The words "the share of" in s 37 of the LPA cater for the situation where a person, who owns an asset together with another person, contributes their share of the asset to the partnership. This is illustrated in Example | Tauira 18.

Example | Tauira 18 - Contribution of a share of an asset

> A couple decide to start a business using a limited partnership ownership structure and contribute a property that they co-own to the partnership. Each person contributes their ownership share of the property to the partnership. An amount equal to the value of the share is included in each person's investment amount as a capital contribution.

421. The words "agreed to be contributed" in s 37 of the LPA appear to refer to an agreement to later provide an asset, rather than a fiction about the value of assets that have been contributed.

422. The assignment of assets to a partner under s 38(2) of the LPA is discussed at [425]. These words correspond to the next component of the investments amount: the amount paid by the partner as an entering partner for the assignment of an interest in partnership property to them.

423. Under s 37(3) of the LPA, a loan by a partner to a limited partnership is not a capital contribution. However, for the purposes of s HG 11, the definition of capital contribution is extended to cover loans. The definition of capital contribution includes amounts that the limited partnership is "debtor for in relation to the partner" and specifically includes a loan to the limited partnership and a credit balance in a current account. This is illustrated in Example | Tauira 19 and Example | Tauira 20. A loan a partner has acquired (with the partnership as debtor) also falls within this definition.

424. The repayment of loans is included in the "distributions" amount (see from [441]).

184 See s HG 11(2)(a).

185 See definition of "capital contribution" in s HG 11(12).

Example | Tauira 19 – Contribution of assets and loan

Partners 1 and 2 establish a limited partnership. Partner 1 agrees to immediately loan $2 million to the partnership, and partner 2 agrees that three months later they will contribute land with a market value of $2 million. Each partner has made a capital contribution of $2 million, which is included in their investments amount.

Example | Tauira 20 – Credit to current account

Partner 1 sells a vehicle it held in its own name to limited partnership A for $30,000. The partnership pays for the car by making a $30,000 credit to the partner's current account with the partnership.

The credit to the current account is an amount the partnership is debtor for in relation to the partner. An amount of $30,000 is added to partner 1's investments amount as a capital contribution.

Amount paid by a partner as an entering partner for the assignment of an interest in partnership property to them

425. The investments amount includes an amount paid by the partner as an entering partner for the assignment of an interest in partnership property to them.[186] This could apply to a new partner or an existing partner who increases their partnership share.

426. This amount corresponds to an amount that is included in the definition of capital contribution in s 37 of the LPA, being the share of assets assigned to the partner under s 38(2) of the LPA.

427. Section 38 of the LPA is about the "partnership interests of a partner", which is defined in s 38(1) of the LPA. Notably, the partnership interests of a partner include the partner's share of the assets of the limited partnership. Section 38(2) of the LPA states that a partner may assign or otherwise dispose of all or part of that person's partnership interests (including their share of the assets) to another partner or, if approved by the partnership, any other person.

428. This amount is relevant for an entering partner who has acquired some or all of an exiting partner's partnership interests. In calculating the entering partner's partner's basis, they will have an investments amount that includes the amount they paid for the assignment of an interest in partnership property to them.

429. This is illustrated in Example | Tauira 21.

Example | Tauira 21 - Amount the partner paid for the assignment of an interest in partnership property

Limited partnership A has two existing limited partners, partners 1 and 2, who have equal partnership shares.

Partners 1 and 2 have each made capital contributions of $750,000.

Limited partnership A's financial position has improved as the business has grown. It now has assets valued at $6.6 million and liabilities of $3 million. Partners 1 and 2 each have an interest in the partnership with a market value of $1.8 million.

A new limited partner (partner 3) joins the partnership and takes a one-third partnership share. As consideration, based on the market value of the business, partner 3 pays partner 1 and partner 2 $600,000 each. Following this, the three partners each have an interest in the partnership worth $1.2 million.

By acquiring a one-third partnership interest, partner 3 has acquired a one-third share in the assets of the partnership.

This means that partner 3 has an initial investment amount of $1.2 million to include in their partner's basis.

Partners 1 and 2 each continue to have investment amounts that include their $750,000 capital contributions. Partners 1 and 2 may also have other partner's basis amounts, including amounts included in the "income" component of the partner's basis calculation (the "income" component is discussed from [446]), which includes realised capital gains. This could include any capital gains realised when assets were assigned to partner 3 as part of partner 3's acquisition of partnership interests.

186 Section HG 11(5)(b).

Secured amounts

430. The investments amount includes "secured amounts", but only to the extent to which secured amounts are not already included in the investments amount as capital contributions in the form of loans made to the partnership by other partners (see [423]). As discussed below, a secured amount is an amount of debt that is guaranteed by a partner or a partner's associate. The debt that is guaranteed could be a loan that was made to the partnership by another partner, which will be included in the capital contribution of the other partner. If so, the guarantee of the loan is not included as a secured amount of the partner who guarantees the loan.

431. The purpose of the secured amounts component is to recognise risks that partners or their "partner's associates" (discussed at [433]) are exposed to as guarantors in relation to partnership debt.

432. Secured amounts can arise for a partner if they are a "guarantor" for an amount of limited partnership debt. A partner is treated as a guarantor for an amount of partnership debt if they guarantee the amount themselves or if they have a partner's associate who guarantees the amount.[187]

433. A "partner's associate" is, for a partner, a person who is not a partner of the relevant limited partnership and who is a:
   - "relative" as defined in s YA 1, but excluding a person who is a relative because they are the trustee of a trust under which a relative has benefited or is eligible to benefit (para (a)(v) of the definition of "relative" in s YA 1); or
   - company in the same wholly-owned group of companies.[188]

434. The secured amounts calculation provides for situations where a partner is not the only person who acts as guarantor for an amount of partnership debt. Where there is more than one guarantor, the secured amounts calculation may include only part of the partnership debt in the partner's secured amounts (even if the partner is jointly liable for the entire amount).

435. A partner's secured amounts is the lesser of the amounts calculated under paras (a) and (b) of the definition of secured amounts in s HG 11(12). Paragraph (b) can only apply to a partner if the terms of a guarantee provided by the partner, or by their partner's associate, limits the lender's recourse to particular property.[189] Limited recourse guarantees are not common, so it is expected in most cases the secured amounts will be calculated under para (a) of the definition of secured amounts.

436. Under para (a), the partner's secured amounts is calculated as the amount of the limited partnership's debt for which the partner is a guarantor (they will be a guarantor if they or their partner's associate guarantees the debt), divided by the total number of guarantors for that debt.[190] In counting the total number of guarantors, both paras (a) and (b) of the definition of "guarantor" apply. This means the total number of guarantors includes a:
   - partner who guarantees the partnership debt;
   - partner who has a partner's associate who guarantees the partnership debt (the partner's associate themselves is not counted as a guarantor); and
   - person who is neither a partner nor a partner's associate who guarantees the partnership debt.

437. The calculation of secured amounts under para (a) is illustrated in Example | Tauira 22.

438. Under para (b) of the definition of secured amounts, the calculation of the partner's secured amounts starts with the market value of the recourse property to the extent of the interest that the partner and the partner's associates have in it.[191] The words "extent of the interest" allow for the situation where a partner or partner's associate owns property together with others as tenants in common (with each owner having a defined share in the property).

187 Definition of "guarantor" in s HG 11(12).

188 Section HG 11(12).

189 Referred to as "recourse property", see definition in s HG 11(12).

190 A guarantee of partnership debt made by a general partner would have no effect because the general partner is jointly and severally liable with the limited partnership for the debt. Therefore, if a general partner does guarantee the partnership debt, they should not be counted as a guarantor.

191 The recourse property may be property in which the partner has an interest or property in which a partner's associate has an interest (if the partner's associate is providing the guarantee).

439. The calculation then subtracts the value of any higher ranking calls on the property (whether actual, future or contingent), then divides the result by the total number of guarantors who have an interest in the property or who have a partner's associate who has an interest in the property. For the purposes of para (b) of the definition of secured amounts, "guarantors" is restricted to partners who have provided a guarantee or who have a partner's associate who has provided a guarantee.[192] This is illustrated in Example | Tauira 23 and Example | Tauira 24.

440. The definition of "secured amounts" can refer to a total of amounts for which a limited partner is a guarantor. This provides for situations where there is more than one item of partnership debt with different guarantees. The definition of secured amounts is applied to each item of partnership debt and the secured amount for a partner for each item are aggregated to determine a partner's secured amounts.

Example | Tauira 22 – Secured amounts where partners provide guarantees

Limited partnership A has two limited partners, partner 1 and partner 2.

Limited partnership A borrows $200,000 from bank A, secured by a mortgage over land the partnership owns. The loan from bank A is not subject to any guarantee.

Limited partnership A also borrows $150,000 from bank B. This loan is guaranteed by partner 1 and partner 2 and by a company (company 1) that is associated with, but not in a wholly-owned group with, partner 1.

The loan from bank A is not guaranteed, so is not relevant to the calculation of the partners' secured amounts.

The $150,000 loan from bank B is guaranteed by partner 1, partner 2 and company 1. The total number of guarantors is three. Therefore, partners 1 and 2 each have secured amounts of $50,000. Company 1 is counted as a guarantor (under para (b) of the definition of that term) because it is neither a partner nor a partner's associate. Although company 1 is associated with partner 1, it is not a "partner's associate" because it is not in the same wholly-owned group.

The secured amounts will increase partner 1 and partner 2's investment amount and, therefore, their partner's basis amounts, which will potentially allow the partners higher deductions.

Example | Tauira 23 – Secured amounts – limited recourse guarantee

This example has four variations that share the following common facts and tax treatment.

Common facts and tax treatment

Company 1 is a limited partner in limited partnership A.

Limited partnership A borrows $1.5 million.

Company 1 and company 2 provide guarantees for this loan. Company 1 and company 2 are associated companies but are not in the same wholly-owned group.

The guarantees are limited recourse guarantees, with recourse limited to a property owned together by companies 1 and 2 (not partnership property). The property has a market value of $1.4 million and is not subject to any higher-ranking call.

Under para (a) of the definition of secured amounts, company 1, as a limited partner of limited partnership A, would have secured amounts of $750,000. This is equal to the debt of $1.5 million divided by the number of guarantors, which is two. This applies for all the variations below.

The following four variations consider the secured amounts that company 1 would have under para (b) and compare this with the amount under para (a). Company 1's secured amounts will be the lower of the amounts given by paras (a) and (b).

192 For the purposes of para (b) of the definition of "secured amounts" only para (a) of the definition of "guarantor" applies.

Variation 1 – Guarantee provided by two partners who own recourse property as joint tenants

Companies 1 and 2 are limited partners in limited partnership A.

Companies 1 and 2 own the recourse property as joint tenants.

As a joint tenant, company 1 has an interest in the full $1.4 million value of the property. Under para (b) of the definition of secured amounts, the $1.4 million amount is divided by the number of guarantors who have an interest in the recourse property, which is two.

Company 1, as a partner, would have secured amounts of $700,000 under para (b). This is less than the $750,000 secured amounts that would be given by para (a).

Therefore, company 1's secured amounts is $700,000. This amount will increase company 1's investment amount and, therefore, its partner's basis amount, which will potentially allow it higher partnership deductions.

Variation 2 – Guarantee provided by two partners who own recourse property as tenants in common

Companies 1 and 2 are limited partners in limited partnership A.

Companies 1 and 2 own the recourse property as tenants in common, with equal shares.

As a tenant in common, the guarantee provided by company 1 in the land is limited to company 1's interest in the property, which is $700,000. Company 1 is the only guarantor with an interest in the recourse property (the $700,000 share in the property held as a tenant in common). Therefore, the market value of the recourse property is divided by one.

Company 1, as a partner, would have secured amounts of $700,000 under para (b). This is less than the $750,000 secured amounts that would be given by para (a).

Therefore, company 1's secured amounts is $700,000.

Variation 3 – Guarantee provided by partner and non-partner who own recourse property as joint tenants

Company 1 is a limited partner in limited partnership A. Company 2 is not.

Companies 1 and 2 own the recourse property as joint tenants.

As a joint tenant, company 1 has an interest in the full $1.4 million value of the property. This amount is divided by the total number of guarantors who have an interest in the recourse property.

In this variation there is only one guarantor, company 1. In para (b) of the definition of secured amounts the relevant divisor is the total number of guarantors described in para (a) of the definition of guarantor, company 2 does not come within para (a) of the definition of guarantor because it is not a partner.

Company 1, as a partner, would have secured amounts of $1.4 million under para (b). This is more than the $750,000 secured amounts that would be given by para (a).

Therefore, company 1's secured amounts is $750,000.

Variation 4 – Guarantee provided by partner and non-partner who own recourse property as tenants in common

Company 1 is a limited partner in limited partnership A. Company 2 is not.

Companies 1 and 2 own the recourse property as tenants in common, with equal shares.

As a tenant in common, company 1 has a $700,000 interest in the property. This amount is divided by the total number of guarantors who have an interest in the recourse property, which is one. Company 1 is the only guarantor for the purpose of para (b) of the definition of "secured amounts" (and the only guarantor who has an interest in the recourse property (the $700,000 share in the property held as a tenant in common).

Company 1, as a partner, would have secured amounts of $700,000 under para (b). This is less than the $750,000 secured amounts that would be given by para (a).

Therefore, company 1's secured amounts is $700,000.

Example | Tauira 24 – Secured amounts with limited recourse property and partner's associate

Facts

Limited partnership A has three partners, partners 1, 2 and 3. Partners 1 and 2 are both in the same wholly-owned group of companies, along with company 1.

Limited partnership A borrows $4.5 million from a lender.

Company 1 and partner 3 provide guarantees for the loan. The lender's recourse under the guarantee provided by company 1 is limited to company 1's 50% interest in a piece of land with a market value of $8 million. Company 1 holds this interest with another company as tenants in common. Company 1's 50% interest in the land is subject to a higher-ranking mortgage of $2 million.

Tax treatment

A partner's secured amounts is the lesser of the amounts given by para (a) or para (b) of the definition of secured amounts in s HG 11(12).

Under para (a), the secured amounts for each partner is equal to the partnership debt divided by the total number of guarantors. Partners 1 and 2 are treated as guarantors in relation to the debt because they have a partner's associate (company 1) who has guaranteed the debt. Partner 3 also provided a guarantee. Company 1, despite guaranteeing the loan, does not come within the definition of guarantor in s HG 11(12). Therefore, the total number of guarantors for the debt under para (a) is three. Therefore, the secured amounts for each partner under para (a) would be $1.5 million ($4.5 million of debt divided by three guarantors).

Paragraph (b) could apply to partners 1 and 2 because the guarantee provided by their partner's associate, company 1, limits the lender's recourse to the land. Paragraph (b) has no application to partner 3 because partner 3's guarantee does not limit the lender's recourse.

Under para (b), the calculation of the secured amounts begins with the market value of the recourse property for the secured debt to the extent of the interest that the partner and the partner's associates have in it. Company 1 has a 50%, or $4 million, interest in the recourse property. The calculation of the secured amounts then subtracts any higher-ranking calls. In this case, company 1's interest in the land is subject to a $2 million mortgage. Therefore, the value of the recourse is only $2 million. This amount is then divided by the number of guarantors who have an interest in the property or who have a partner's associate who has an interest in the property. In this case, both partners 1 and 2 have a partner's associate, company 1, with an interest in the property. Company 1 is not counted as a guarantor. Therefore, the recourse amount is divided by two. Therefore, para (b) would result in partners 1 and 2 having secured amounts of $1 million each.

For partners 1 and 2, the amount given by para (b) of the definition of secured amounts is lower than the amount given by para (a), so the para (b) amount is their secured amounts ($1 million each) for the purposes of calculating their partner's basis.

For partner 3, only para (a) applies and that gives partner 3 secured amounts of $1.5 million.

The partners' secured amounts will increase their investment amounts and, therefore, their partner's basis amounts, which will potentially allow them higher partnership deductions.

Distributions

441. The second main part of the partner's basis calculation is distributions. This includes the following components, the:[193]

- market value of distributions to the partner from the limited partnership;
- amount paid to the partner as an exiting partner for the assignment of an interest in partnership property by them; and
- capital contributions made by a limited partner by way of loan that are repaid by the partnership or for which the partnership is otherwise no longer a debtor in relation to the partner.

193 Section HG 11(6).

442. The word distributions as used in the first component is not further defined for the purposes of s HG 11.

443. A distribution is also made when a partner withdraws some or all of a credit balance from their current account. This is illustrated in Example | Tauira 25.

444. The second component is the same as the assignment amount included in the investments amount, except seen from the perspective of the exiting partner. The amount is that paid to the exiting partner for the assignment of assets (which are included in the partnership interests that are assigned) by the exiting partner to the entering partner. This is illustrated in Example | Tauira 26.

445. The distributions amount includes amounts distributed or paid in the current income year and previous income years.[194]

Example | Tauira 25 - Distribution – withdrawal of credit in current account

Partner 1 is a limited partner in limited partnership A.

Partner 1 has a $40,000 credit balance in their current account with the partnership.

Partner 1 needs some money to buy a new car, so asks limited partnership A to transfer $50,000 to their personal bank account. Limited partnership A makes the transfer and records a debit of $50,000 to partner 1's current account with the partnership.

As a result, $40,000 is included in partner 1's distributions amount. The other $10,000 paid to partner 1 is a loan to the partner from the partnership and does not affect partner 1's partner's basis.

Example | Tauira 26 - Distribution – amount paid to partner for assignment of capital contribution

This example uses the same facts as Example | Tauira 21.

Limited partnership A has two existing limited partners, partners 1 and 2, who have equal partnership shares.

Partners 1 and 2 have each made capital contributions of $750,000.

Limited partnership A's financial position has improved as the business has grown. It now has assets valued at $6.6 million and liabilities of $3 million. Partners 1 and 2 each have an interest in the partnership worth $1.8 million.

A new partner (partner 3) joins the partnership and takes a one-third partnership share. As consideration, based on the market value of the business, partner 3 pays partners 1 and 2 $600,000 each. Following this, the three partners each have an interest in the partnership worth $1.2 million.

By acquiring a one-third partnership interest, partner 3 has acquired a one-third share in the assets of the partnership.

Partner 1 has been paid $600,000 for the assignment by partner 1 to partner 3 of a share of the assets of the partnership. Therefore, this amount is included in partner 1's distributions amount. The same is true for partner 2.

Overall:

- partners 1 and 2 each continue to have investments amounts that include their $750,000 capital contributions, but they also have distribution amounts that now include an additional $600,000 each, and they may also have accumulated partner's basis from profits in previous years and from realised capital gain amounts; and
- partner 3 has an initial investments amount of $1.2 million to include in their partner's basis.

194 This is not specified in s HG 11(6), but it would be consistent with the purpose of the partner's basis calculation to include these amounts.

Income

446. The third main amount included in the partner's basis calculation is "income". Income is specifically defined for this purpose and has three components:[195]
   - income the partner has by virtue of s HG 2;
   - a FIF dividend adjustment; and
   - capital gain amounts the partner would have by virtue of s HG 2.

Income the partner has by virtue of s HG 2

447. The first component is income the partner has as a partner of the partnership by virtue of s HG 2. "Income" in this context has its normal income tax meaning. It includes income that may be exempt income, excluded income, non-residents' foreign-sourced income or assessable income.
448. This component specifically includes income the partner has in the current income year and previous income years.[196]

FIF dividend adjustment

449. The income amount includes what is referred to in this statement as a FIF dividend adjustment.[197]
450. This adjustment recognises that dividends received by a partner from a foreign investment fund (FIF) can exceed the partner's FIF income under the ITA (if any) for the FIF. The purpose of the partner's basis calculation is to determine the partner's economic investment in the partnership. To do this, it is necessary to recognise the extent to which the dividends are higher than FIF income.
451. This calculation is performed for the current income year and previous income years and for each FIF the partnership holds in each year.
452. An adjustment is required in relation to a FIF and an income year if the:
   - partner has FIF income or a FIF loss from a FIF;
   - partner has a share of a dividend from the FIF (see [453]); and
   - share of the dividend is greater than the FIF income (if the partner has FIF income).
453. For the purpose of calculating a FIF dividend adjustment, the share of a dividend that a partner has from a FIF is the share that they would have if ss CD 36 (foreign investment fund income) and HG 2(2) were ignored. Section CD 36 prevents an amount paid by a company to a person from being a dividend if the person has an attributing interest in the company. Generally, the no-streaming rule in s HG 2(2) would treat all the partners as having a share of a dividend based on each partner's partnership share in the partnership's income. These provisions are ignored in determining the partner's share of a dividend because the purpose of the partner's basis amount is to represent the partner's economic investment.
454. For each FIF the partnership holds, a partner needs to determine the following amount:
   - if the partner's share of the dividend is equal to or less than the FIF income, zero;
   - if the partner's share of the dividend is greater than the partner's FIF income, the amount equal to the partner's share of the dividend less the partner's FIF income; or
   - if the partner has no FIF income, or has a FIF loss, an amount equal to the partner's share of the dividend.
455. The total of all such amounts for each FIF and for each income year is the FIF dividend adjustment.
456. This is illustrated in Example | Tauira 27.

195 Section HG 11(7).
196 Section HG 11(7)(a).
197 Section HG 11(7)(ab).

Example | Tauira 27 – FIF dividend adjustment

Partner 1 is a partner of limited partnership A. Limited partnership A was formed at the beginning of the 2022 income year.

Limited partnership A has overseas investments that give partner 1 attributing interests in two FIFs.

Under limited partnership A's partnership agreement, dividends from FIF 1 are shared with only some of the partners, including partner 1. Dividends from FIF 2 are shared according to the partners' partnership shares in the assets of the partnership.

Partner 1 needs to calculate their partner's basis for the 2023 income year. Partner 1 did not calculate their partner's basis for the 2022 income year because the partnership had net income in that year. Without any running balance of the partner's basis, partner 1 needs to consider both the 2022 and 2023 income years.

2022 income year

<u>FIF 1</u>

Partner 1 has FIF income of $10,000 from FIF 1 and receives an $11,500 share of a dividend from FIF 1.

For tax purposes, partner 1 is treated by s HG 2(2) (the no streaming rule) as receiving a share of the dividend from FIF 1 that is less than $11,500. However, it is the share that partner 1 would have ignoring ss CD 36 and HG 2(2) that is relevant to the calculation of the FIF dividend adjustment. Also, it is not relevant to the FIF dividend adjustment that the dividend from FIF 1 is excluded income.[198]

The FIF dividend adjustment includes $1,500 ($11,500 less $10,000) in relation to FIF 1 and the 2022 income year.

<u>FIF 2</u>

Partner 1 has FIF income of $10,000 from FIF 2 and receives an $8,500 share of a dividend from FIF 2.

No amount is included in the FIF dividend adjustment in relation to FIF 2 and the 2022 income year. The dividend does not exceed the FIF income.

2023 income year

<u>FIF 1</u>

Partner 1 has a FIF loss of $1,000 from FIF 1 and receives a $2,400 share of a dividend from FIF 1.

The FIF dividend adjustment includes $2,400 in relation to FIF 1 and the 2023 income year.

<u>FIF 2</u>

Partner 1 has FIF income of $10,000 from FIF 2 and receives a $12,000 share of a dividend from FIF 2.

The FIF dividend adjustment includes $2,000 ($12,000 less $10,000) in relation to FIF 2 and the 2023 income year.

Overall

In determining partner 1's partner's basis for the purposes of the 2023 income year, in the income amount, partner 1 will have a FIF dividend adjustment of $5,900 ($1,500 from the 2022 income year, and $2,400 and $2,000 from the 2023 income year).

Capital gain amounts

457. The income amount also includes realised capital gain amounts.

458. The capital gain amounts included are those the partner would have under s CD 44(7)(a) if the partner was treated as:

- holding property that is held by the limited partnership under s HG 2; and
- a company.

198 Section CX 57B.

459. For a capital gain amount to arise under s CD 44(7)(a), the partnership must have disposed of property.[199] Therefore, the income amount is concerned with realised capital gain amounts.

460. However, capital gain amounts are not included if they have already been accounted for under s HG 11(7)(a) (income the partner has as a partner of the partnership).

461. This component specifically includes amounts for the current income year and previous income years.

Deductions

462. The fourth main part of the partner's basis calculation is "deductions". The deductions amount consists of two components:[200]

- expenditure or loss the partner has as a partner; and
- capital loss amounts.

Expenditure or loss the partner has as a partner

463. This component (expenditure or loss the partner has as a partner) includes only expenditure and loss amounts incurred as a partner (by virtue of s HG 2) and only to the extent to which the expenditure or loss is incurred in deriving income.

464. Also, this component is limited to expenditure and loss amounts from previous income years. This is because expenditure and loss amounts for the current income year are part of the limited partnership deduction amount that is tested under s HG 11.

465. Also, expenditure or loss amounts for which deductions have been denied under s HG 11 in the previous income years are excluded. These are also included in the limited partnership deduction amount that is tested under s HG 11.

466. This is illustrated in Example | Tauira 28.

Example | Tauira 28 - Expenditure or loss amounts and partner's basis

2022 income year

For the 2022 income year, partner 1 had:

- limited partnership deductions of $500;
- assessable income of $400; and
- a partner's basis of $450.

Partner 1 had a $100 loss for the 2022 income year from the limited partnership and their limited partnership deductions were more than their partner's basis. The difference between the limited partnership deductions and the partner's basis ($50) is less than the loss amount ($100), so the deduction denied is $50.

2023 income year

In the 2023 income year, partner 1 has:

- assessable income of $300;
- expenditure as a partner of $300; and
- limited partnership deductions that were denied in the previous income year of $50.

For the 2023 income year, partner 1's partner's basis includes (for the first time) the expenditure and loss amounts incurred in 2022 of $500. The expenditure and loss amounts were not included in the calculation of the partner's basis in the 2022 income year because the partner's basis (in particular, the deductions amount) does not include current year expenditure or loss. Partner 1's partner's basis also includes the current year assessable income of $300. No other changes occurred in the year that affect the partner's basis. This means the partner's basis for 2023 is $250 ($450 less $500 plus $300).

199 Any kind of property, not just land or buildings.

200 Section HG 11(8).

Partner 1's limited partnership deductions for the 2023 income year are $350 (current year expenditure of $300 plus the deductions denied in 2022 of $50). Therefore, partner 1 has a $50 loss for the 2023 income year ($300 of assessable income less the limited partnership deductions of $350).

Partner 1's limited partnership deductions of $350 are also more than their partner's basis of $250. Partner 1's loss of $50 is smaller than the difference between the limited partnership deductions and their partner's basis, so the deduction disallowed in 2023 is the loss amount of $50.

Capital loss amounts

467. The "deductions" amount also includes realised capital loss amounts.

468. The capital loss amounts included are those the partner would have under s CD 44(9) if the partner was treated as:

- holding property that is held by the limited partnership under s HG 2; and
- a company.

469. For a capital loss amount to arise under s CD 44(9), the partnership must have disposed of property.[201] Therefore, the "deductions" amount is concerned with realised capital loss amounts.

470. However, capital loss amounts are not included if they have already been accounted for under s HG 11(8)(a) (expenditure or loss the partner has as a partner of the partnership).

471. This component specifically includes amounts for the current income year and previous income years.

Disallowed amount

472. The fifth and final part of the partner's basis calculation is the "disallowed amount".

473. This is the amount of investments, as defined in s HG 11(5), the partner made within 60 days of the last day of the income year, if those investments are or will be distributed or reduced within 60 days after the last day of the income year.[202]

474. This is an anti-avoidance provision aimed at deterring people from artificially inflating their partner's basis by making a temporary capital contribution into the partnership for the end of the income year (the partner's basis is calculated at the end of the year).

201 Any kind of property, not just land or buildings.

202 Section HG 11(9).

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IS 25/12: Income tax – Using the cost method to determine foreign investment fund (FIF) income

Issued | Tukuna: 4 April 2025

This interpretation statement explains when a New Zealand tax resident investor can choose to apply the cost method to calculate their foreign investment fund (FIF) income on shares held in foreign companies. It includes some examples on when an independent valuation may be required to apply the cost method and how the cost method can be applied.

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

Summary | Whakarāpopoto

1. This interpretation statement clarifies that a New Zealand tax resident investor can choose to apply the cost method to calculate foreign investment fund (FIF) income on shares held in foreign companies if the market value of their shares at the start of their income year is not readily available (ie, not easily obtained).
2. The cost method will generally be unavailable for listed shares as the market value of the shares will be readily available from a recognised exchange.
3. The cost method will generally be available for unlisted shares. This is because often the market value of such shares will not be readily available without spending the time and resources to determine the market value of the company and its shares. Each case should be looked at in light of its own facts. For example, the market value could be considered to be readily available (and thus the cost method would be unavailable) where the company or fund manager provides a market valuation of the shares as at the start of the investor's income year. This is provided the reported valuation objectively reflects the "market value" of the unlisted shares as defined, considering readily available information.
4. The decision process for being able to use the cost method is summarised in Figure | Hoahoa 1: When an investor of ordinary shares in a foreign company can use the cost method.
5. This interpretation statement also clarifies that an independent valuation is often not required to access the cost method. However, in certain circumstances an independent valuation may be required on entry to the cost method, such as where a previous exemption from the FIF rules ceases to apply for the investor.

Introduction | Whakataki

6. This interpretation statement explains when a New Zealand tax resident investor can choose to apply the cost method to calculate their FIF income on shares in foreign companies. The foreign shares must be an attributing interest and not exempt from the FIF rules.
7. In this interpretation statement, all amounts are expressed in New Zealand dollars.[1] All legislative references are to the Income Tax Act 2007 (the Act).

Overview of the FIF rules

8. The FIF rules apply to a person if they are a New Zealand tax resident who has certain kinds of investments overseas and no FIF exemption applies. FIF investments include a direct income interest in a foreign company, which can be a foreign unit trust.
9. A person may have FIF income if they hold rights in a FIF investment that is an attributing interest in a FIF[2] and they are not exempt. Two common exemptions from the requirement to return FIF income are for transitional residents and attributing FIF interests where the investor's total cost does not exceed $50,000.

1 There are rules relating to currency conversions when calculating FIF income. Examples of how to convert foreign currency amounts can be found in *Tax Information Bulletin* Vol 31 No 11 (December 2019) at 2 and FX 21/01: Foreign exchange rates.

2 That is, where none of the FIF exemptions in ss EX 31 to EX 43 applies. See s EX 29.

10. Where the FIF rules apply, a New Zealand tax resident investor must calculate and return FIF income on attributing interests in FIFs held. Section EX 44(1) provides five methods for calculating the amount of FIF income for an attributing interest:
    - the fair dividend rate (FDR) method;
    - the comparative value (CV) method;
    - the cost method;
    - the deemed rate of return (DRR) method; and
    - the attributable FIF income method.
11. Section EX 44(2) places restrictions on which method a person can choose with reference to other sections in the Act. For example, s EX 47 requires a person to use the CV method or the DRR method for an attributing interest in a non-ordinary share.
12. A wide range of investments can be an attributing interest in a FIF and several methods for calculating FIF income are possible depending on the investment.[3] Unless stated otherwise, this interpretation statement focuses on an attributing interest in a FIF where:
    - the New Zealand tax resident investor owns ordinary shares in a foreign company, or units in a foreign unit trust;
    - the share is not subject to a returning share transfer[4] or share reorganisation;[5]
    - the total cost of all the investor's attributing FIF investments is over $50,000;
    - the investor is not a transitional resident; and
    - the investor is not seeking to change the FIF calculation method applied in a previous income year.

When the cost method can be applied

13. As noted at [11], the choice of method available for determining FIF income may be subject to restrictions. Most people are likely to determine their FIF income using the simplest method for which they and their investment are eligible to use. A general rule is that once a person uses a particular method, they must use it in the following years.[6]
14. This interpretation statement focuses on when a New Zealand tax resident investor may choose to apply the cost method to determine FIF income arising on their investment.
15. The FDR method (and CV method for natural persons and eligible trustees) are generally simple and the most frequently used for listed shares, but both methods require the market value of the shares to be known. Thus, the cost method can be a practical alternative for determining FIF income on unlisted shares, subject to satisfying any requirements.
16. Section EX 46(9) sets out the circumstances in which the cost method can be used:

> **EX 46 Limits on choice of calculation methods**
>
> *Cost method for shares in foreign companies*
>
> (9) A person may use the cost method to calculate FIF income or loss from an attributing interest in a FIF if—
>
> (a) the attributing interest is a share in a foreign company for which the fair dividend rate method is allowed; and
>
> (b) the market value of the attributing interest at the start of the income year is not readily available.

3 See IR461 – Guide to foreign investment funds (August 2022) for a more detailed overview of the FIF rules.

4 A returning share transfer is generally an arrangement where a share is transferred from a share supplier to a share user, and it is agreed that the user will make a replacement payment to the supplier if a dividend is payable and that the share (or an identical share) may be transferred from the user back to the supplier. See s YA 1.

5 A share reorganisation is generally an action of the FIF that causes an increase or reduction, other than for consideration, of the attributing interests the person holds. See s YA 1.

6 An exception to the general rule allows natural persons and eligible trustees to choose between the FDR and CV methods from one year to the next. Further, s EX 62 sets out the circumstances where an investor can change their FIF calculation method. The choice of FIF calculation method is discussed in more detail in *Tax Information Bulletin* Vol 24 No 6 (July 2012) at 20-23.

17. An investor can only choose to apply the cost method to calculate their FIF income on their foreign company shares[7] that are a FIF attributing interest if:
    - the use of the FDR method is allowed; and
    - the market value of the attributing interest at the start of the income year is not readily available.
18. In the common situation described at [12], the use of the FDR method is allowed for the foreign shares as the investment is an attributing interest in a FIF and there is no requirement to use a particular calculation method.[8] If the market value at the start of the income year of the foreign shares is not readily available, then the investor can choose to use the cost method. Alternatively, the investor can choose to incur compliance costs to get an annual market valuation to apply the FDR method even if they are eligible to use the cost method.
19. The meaning of "market value" and whether it is "readily available" is discussed next.

Market value and whether it is readily available

20. For listed shares, "market value" is generally the share price quoted on a recognised exchange. For unit trusts, other information that is verifiable and may be used includes published unit prices or the net asset values at which units can be redeemed. Exit values that incorporate a penalty for early withdrawal or redemption are not acceptable as they do not provide a fair reflection of market value for a share on the same terms.[9]
21. For unlisted shares, "market value" is the amount a willing purchaser would pay to acquire the share in an arm's length acquisition at the time. It must be determined using a method that conforms with commercially acceptable practice and results in a valuation that is fair and reasonable.[10]
22. For example, a valuation that a suitably qualified person prepares using a commercially acceptable valuation method for the circumstances of the entity could meet this definition. A market valuation that an unlisted foreign company prepares internally for commercial purposes can in some circumstances satisfy the definition of market value. Objective consideration should be given to whether the provided valuation satisfies the definition of "market value" in the Act, and documentation should be retained to verify whether a valuation reflects "market value". Practically, this means that if there are factors that indicate the valuation provided for the unlisted share is unlikely to reflect the price that a willing purchaser would pay for that interest, then the cost method will generally be available to the investor as there is no readily available "market value" as defined.[11]
23. The phrase "readily available" is not defined for the purposes of the Act and has its ordinary meaning in context. "Readily" means without delay, without difficulty or as may easily happen.[12] "Available" means able to be used or obtained.[13] Accordingly, market value of an attributing interest is "readily available" where it can be easily obtained for preparing the investor's tax return, that is, without delay or difficulty for its required purpose.
24. If the market value at the start of the income year of the foreign shares the investor holds can be easily obtained, the investor cannot use the cost method. For this reason, the cost method will generally not be available for investors of listed shares as the market value can be easily obtained from a recognised exchange.
25. The cost method will generally be available for unlisted shares. This is because often the market value of such shares cannot be easily obtained as more time and resources may be required to obtain a market value that meets the requirements of the Act. As discussed at [21], this requires a fair and reasonable valuation to be determined using a method that conforms with commercially acceptable practice. Objectively, this indicates there is some difficulty or delay involved to obtain the market value, so the market value is not "readily available".

7 "Shares" as defined in s YA 1 includes units in a unit trust.

8 This is consistent with ss EX 46, EX 47 and EX 62.

9 Under para (a) of the definition of "market value" in s YA 1 and *Tax Information Bulletin* Vol 19 No 3 (April 2007) at 36.

10 Under para (b) of the definition of "market value" in s YA 1.

11 For example, this could be due to the valuation not accounting for factors that would ordinarily affect market value such as liquidity or level of control.

12 *Shorter Oxford English Dictionary* (6th ed, Oxford University Press, 2007).

13 *Shorter Oxford English Dictionary* (6th ed, Oxford University Press, 2007).

26. However, each case should be looked at in light of its own facts. For example, the market value of an unlisted share could be considered as "readily available" (and thus the cost method would be unavailable) where the company or fund manager provides a market valuation of the shares as at the start of the investor's income year (eg, as part of investor communications or reporting), as there would be little time or expense involved in obtaining the valuation. This is provided the reported valuation objectively reflects the "market value" of the unlisted shares as defined in the Act, considering readily available information. Example | Tauira 2 below illustrates a situation when a reported valuation is not "market value" based on available information.

Example | Tauira 1 – Whether market value of units in a foreign unit trust at the start of the investor's income year is readily available

Wiremu acquired units in an unlisted Australian unit trust (AUT) that invests in a portfolio of listed investments for $100,000 in October 2022. The investment is an attributing interest in a FIF and no exemptions apply. Wiremu is a New Zealand tax resident with a standard March balance date.

The AUT only provides its investors with unit prices as at 30 June each year within 1-2 months of the valuation date.

The use of the FDR method is allowed for the investment as it is an attributing interest in a FIF and there is no requirement to use a particular calculation method. However, the market value of the attributing interest at the start of Wiremu's income year is not readily available as he cannot easily obtain a market valuation. For example, he would either need to incur costs to obtain an independent valuation, or do a detailed analysis and calculation to determine the market value himself.

Therefore, Wiremu may choose to apply the cost method to calculate the FIF income arising on his investment as an alternative to the FDR or CV method.

Alternatively, if the AUT instead reported on a quarterly basis and the published unit prices reflect the expected redemption value, Wiremu would not be able to apply the cost method as the market value of the attributing interest at the start of the income year can be easily obtained in time for preparing his tax return.

Example | Tauira 2 – Market value of shares in an unlisted foreign company not readily available as reported value is unlikely to reflect market value

Anna acquired a 2% interest in an unlisted United Kingdom (UK) company that holds illiquid assets. The investment is an attributing interest in a FIF and no exemptions apply. Anna is a New Zealand tax resident with a standard March balance date.

The UK company provides quarterly valuations and reports its approximate market value as $25 million (so Anna's proportionate share would be $500,000). The $25 million valuation of the unlisted UK company reflects its valuation of the company as a whole rather than any individual shareholding parcels. Anna does not have any transfer rights or control over when she can buy more shares or sell her shares.

The use of the FDR method is allowed for the investment as it is an attributing interest in a FIF and there is no requirement to use a particular calculation method. However, the market value of the attributing interest is not readily available as it is unlikely that the valuation provided by the UK company reflects the price that a willing purchaser would pay for that interest due to it being a minority interest with no control rights, and the lack of liquidity.

Therefore, Anna may choose to apply the cost method to calculate the FIF income arising on her investment as an alternative to the FDR or CV method.

Applying the cost method – When an independent valuation is required

27. The cost method taxes 5% of the cost[14] of a person's attributing interest, plus any adjustments for shares bought and sold within the same income year (quick sales). No FIF income arises in the year in which the attributing interest is first acquired, as the cost or opening value was nil at the start of that year, provided there is no adjustment for quick sales during the income year. In the following years, the cost or opening value is then generally uplifted by 5% each year as a proxy for investment growth[15], plus an adjustment for any sales and purchases in the previous year (if there are any). Any dividends under this method are treated as excluded income and not taxed. Taxpayers are generally required to make a disclosure of their attributing interest as part of filing their tax return unless an exemption applies.[16]

28. An independent valuation is only required in certain circumstances to access the cost method, such as where the FIF investment was previously exempt from the FIF rules.[17]

29. For example, an independent valuation will be required as a one-off requirement to access the cost method where the investor previously did not have an attributing interest which gave rise to FIF income. This may apply where the total cost of their attributing interest in FIFs was $50,000 or less, or a FIF exemption ceases to apply. See Example | Tauira 3 and Example | Tauira 4.

30. The words "independent" and "valuation" are not defined for the purposes of the Act and have their ordinary meaning in context. "Independent" means not influenced or affected by others; (referring to an inquiry or similar carried out by people) outside the organisation concerned.[18] "Valuation" means an estimation of something's worth, especially an estimation that a professional valuer carries out.[19]

31. Case law indicates that to be "independent", a person would bring "an independent mind to bear on a particular problem".[20] A person who is associated or connected with the entity or acting as agent for the entity may not have independence in setting the business value for the entity. A person needs to possess business qualifications and be at arm's length to produce an independent valuation.[21]

32. Accordingly, in this context, an "independent valuation" is a valuation provided by a suitably qualified expert in share valuations, who is at arm's length of both the entity that issued the shares and the investor holding the shares.

14 This is the "opening value" determined under s EX 56.

15 Unless the investor chooses to use the net asset value in audited financial statements (under s EX 56(3)(ab)) or an independent valuation (under s EX 56(3)(b)(ii)) to reset their opening value.

16 See the International Tax Disclosure Exemption determination published by the Commissioner each year (usually included in the *Tax Information Bulletin* for the month of April). Generally, no exemption has been provided for the cost method.

17 That is because s EX 56(3)(b)(i) applies where the interest was not an attributing interest for which the person has FIF income or loss for the income year before the relevant income year.

18 *Shorter Oxford English Dictionary* (6th ed, Oxford University Press, 2007).

19 *Shorter Oxford English Dictionary* (6th ed, Oxford University Press, 2007).

20 *Potato Marketing Board v Merricks* [1958] 2 QB 316 at 335.

21 *Morgenstern v Jeffreys* [2014] NZCA 449; *Tellen Systems NZ (2013) Limited (in rec and in liq) v Fibre Investments Ltd* [2022] NZHC 19.

Example | Tauira 3 – Independent valuation required to apply the cost method following a breach of the $50,000 FIF cost threshold

Circumstances

Lee is a New Zealand tax resident and acquired 30 ordinary shares in an unlisted private company in Hong Kong for $30,000 in June 2018. In January 2024, he acquired a further interest of 20 ordinary shares for $30,000. He did not voluntarily elect to apply the FIF rules in the 2019 to 2023 income years and applied the general tax rules to the investment by returning dividend income received in his tax return. Lee is required to calculate and return FIF income in his 2024 income year as the total cost of all his attributing FIF interests exceeds $50,000 during that income year.

The unlisted company does not publish or report on its market valuation to investors. The market value of the attributing interest at the start of Lee's income year is not readily available as he cannot easily obtain a market valuation. He can apply the cost method to calculate his FIF income and chooses to do so.

Calculation of FIF income under the cost method

2024 income year: First year following the breach of the cost threshold

To determine the opening value under the cost method, Lee is required to obtain an independent valuation of the market value of his interest under s EX 56(3)(b)(i), because he did not meet the test in s CQ 5(1)(d) and so did not have FIF income in the previous income year (ie 2023).[22]

He obtains an independent valuation of the 30 shares he held on 1 April 2023, which provided that his shares are worth $45,000. His income under the cost method for the year ended 31 March 2024 is calculated as follows:

FIF income

= (0.05 × opening value) + quick sale adjustment

= 0.05 × $45,000 + $0

= $2,250

Any dividend income received in the 2024 income year is treated as excluded income and not separately taxed. In addition to returning FIF income of $2,250 in his tax return, he also makes a disclosure of his FIF interest and FIF income by filing IR 449 and IR 1261 forms.

The 20 shares Lee acquired in January 2024 will be accounted for in his opening value for the 2025 income year, reflecting that his opening shareholding on 1 April 2024 increased to 50 shares (from the 30 shares held on 1 April 2023).[23]

22 Practically, this has the same effect as s EX 65 (changes in application of FIF exemptions), which deems the disposition and reacquisition of the interest to be at its market value at the time of the change.

23 Under subs (3)(d) and (5) of s EX 56.

Example | Tauira 4 – Independent valuation obtained to apply the cost method after person ceases being a transitional resident

Circumstances

Amiria acquired 100 ordinary shares in an unlisted private company in Japan in June 2020 for $90,000. Amiria was a transitional resident when she acquired the shares. She ceases being a transitional resident from 1 May 2023.

The company does not publish or report on its market valuation to investors. The market value of the attributing interest at the start of Amiria's income year is not readily available as she cannot easily obtain a market valuation. She can apply the cost method to calculate her FIF income from the 2024 income year onwards and chooses to do so.

Calculation of FIF income under the cost method

2024 income year: First year as a New Zealand tax resident

Following the end of her transitional residency, Amiria is treated as acquiring the unlisted shares at market value on 1 May 2023. She is treated as if she did not hold the interest while she was a transitional resident (under s EX 64).

Amiria's FIF income under the cost method for the year ended 31 March 2024 is $0. This is because her cost base (or opening value) as of 1 April 2023 is $0 as this is the income year in which she is deemed to have acquired the FIF interest.[24]

2025 income year: Second year as a New Zealand tax resident

To determine the opening value, Amiria obtains an independent valuation of the market value of the interest as at 1 May 2023 (the deemed date of acquisition when she ceased being a transitional resident).[25] The valuation provides that her 100 shares are worth $120,000.

Amiria's current opening shareholding increased from 0 shares on 1 April 2023 to 100 shares on 1 April 2024 due to the deemed acquisition on 1 May 2023. As there is a shareholding increase, her income under the cost method for the year ended 31 March 2025 is calculated as follows:

Opening value

= 1.05 × preceding opening + (increase × average cost)[26]

= 1.05 x $0 + (100 x $1,200)

= $120,000

Where:

Preceding opening = $0 (ie the opening value on 1 April 2023)

Increase = 100 – 0 = 100 (ie the difference between the number of shares Amiria is deemed to have held on 1 April 2024 and 1 April 2023)

Average cost = $120,000 / 100 = $1,200 (ie average cost of the 100 shares)

FIF income

= (0.05 × opening value) + quick sale adjustment

= 0.05 × $120,000 + 0

= $6,000

Any dividend income received in the 2025 income year is treated as excluded income and not separately taxed. In addition to returning FIF income of $6,000 in her tax return, she also makes a disclosure of her FIF interest and FIF income by filing IR 449 and IR 1261 forms.

24 Under s EX 56(3)(a).

25 Practically, while s EX 56(3)(b)(i) does not apply (because the interest was an attributing interest in the 2024 income year), the deemed acquisition at market value under s EX 64 when Amiria becomes a New Zealand tax resident achieves the same effect as an independent valuation under s EX 56(3)(b)(i).

26 Under subss (3)(d) and (5) of s EX 56.

33. Where an independent valuation is not required, investors still have the option to use an independent valuation as their initial cost base for applying the cost method if they choose to do so. Investors can also choose to reset their cost base once every 5 years through an independent valuation (eg, if they consider the value of their investment has decreased).

34. Frequently, in the first year after the year when the investor acquired the investment, they can use the original cost as the opening value so an independent valuation is not required. They can also use original cost to account for increases in shareholdings. See Example | Tauira 5.

Example | Tauira 5 – Investor can use original cost as the opening value and to account for increases in shareholdings under the cost method

Circumstances

Jenny acquires 75 ordinary shares in a private unlisted Singaporean company in July 2022 for $75,000. The investment is an attributing interest in a FIF and no exemptions apply. The market value of the attributing interest at the start of Jenny's income year is not readily available as she cannot easily obtain a market valuation. Therefore, Jenny can apply the cost method to calculate her FIF income and chooses to do so.

Jenny buys another 25 ordinary shares in the same company in May 2024 for $40,000. She has no other buying or selling activity for these shares.

Calculation of FIF income under the cost method

The formula for calculating FIF income under the cost method is:

(0.05 × opening value)[27]

2023 income year: First year when investor acquires investment

Jenny's FIF income under the cost method for the year ended 31 March 2023 is $0. This is because her cost base (or opening value) as of 1 April 2022 is $0 as this is the income year in which she acquired the FIF interest.[28]

2024 income year: Second year of investment

Jenny's opening shareholding increased from 0 shares on 1 April 2022 to 75 shares on 1 April 2023. Jenny can use her original cost of the investment for the purpose of determining the opening value of her shares under the cost method and she chooses to do so.[29] As there is a shareholding increase, her income under the cost method for the year ended 31 March 2024 is calculated as follows:

Opening value

= 1.05 × preceding opening + (increase × average cost)[30]

= 1.05 × $0 + (75 × $1,000)

= $75,000

Where:

Preceding opening = $0 (ie the opening value on 1 April 2022)

Increase = 75 – 0 = 75 (ie the difference between the number of shares Jenny held on 1 April 2023 and 1 April 2022)

Average cost = $75,000 / 75 = $1,000 (ie average cost of the 75 shares)

27 No quick sale adjustment is required in any of the income years as Jenny does not buy or sell any shares within the same income year.

28 Under s EX 56(3)(a).

29 Jenny chooses to use original cost under s EX 56(3)(d) as her opening value instead of the net asset value of the interest in audited financial statements (under s EX 56(3)(ab)) or an independent valuation (under s EX 56(3)(b)(ii)). Section EX 56(3)(b)(i) does not apply to **require** an independent valuation in the 2024 income year, because in the 2023 income year the interest was an attributing interest for which she had FIF income, albeit zero.

30 Under subss (3)(d) and (5) of s EX 56.

FIF income

= 0.05 × $75,000

= $3,750

Any dividend income received is treated as excluded income and not separately taxed. In addition to returning FIF income in her tax return, she also makes a disclosure of her FIF interest and FIF income by filing IR 449 and IR 1261 forms.

2025 income year: No change in shareholding

Jenny's shareholding is unchanged between 1 April 2023 and 1 April 2024. Her income under the cost method for the year ended 31 March 2025 is calculated as follows:

Opening value

= 1.05 × preceding opening[31]

= 1.05 × $75,000

= $78,750

FIF income

= 0.05 × $78,750

= $3,937.50

Any dividend income received is treated as excluded income and not separately taxed. In addition to returning FIF income in her tax return, she also makes a disclosure of her FIF interest and FIF income by filing IR 449 and IR 1261 forms.

2026 income year: Shareholding increase in May 2024

Jenny's opening shareholding increased from 75 shares on 1 April 2024 to 100 shares on 1 April 2025. Her income under the cost method for the year ended 31 March 2026 is calculated as follows:

Opening value

= 1.05 × preceding opening + (increase × average cost)

= 1.05 × $78,750 + (25 × $1,600)

= $122,687.50

Where:

Preceding opening = $78,750 (ie the opening value on 1 April 2024)

Increase = 100 – 75 = 25 (ie the difference between the number of shares Jenny held on 1 April 2025 and 1 April 2024)

Average cost = $40,000 / 25 = $1,600 (ie average cost of the 25 shares acquired in May 2024)

FIF income

= 0.05 × $122,687.50

= $6,134.38

Any dividend income received is treated as excluded income and not separately taxed. In addition to returning FIF income in her tax return, she also makes a disclosure of her FIF interest and FIF income by filing IR 449 and IR 1261 forms.

31 Under subss (3)(c) and (4) of s EX 56.

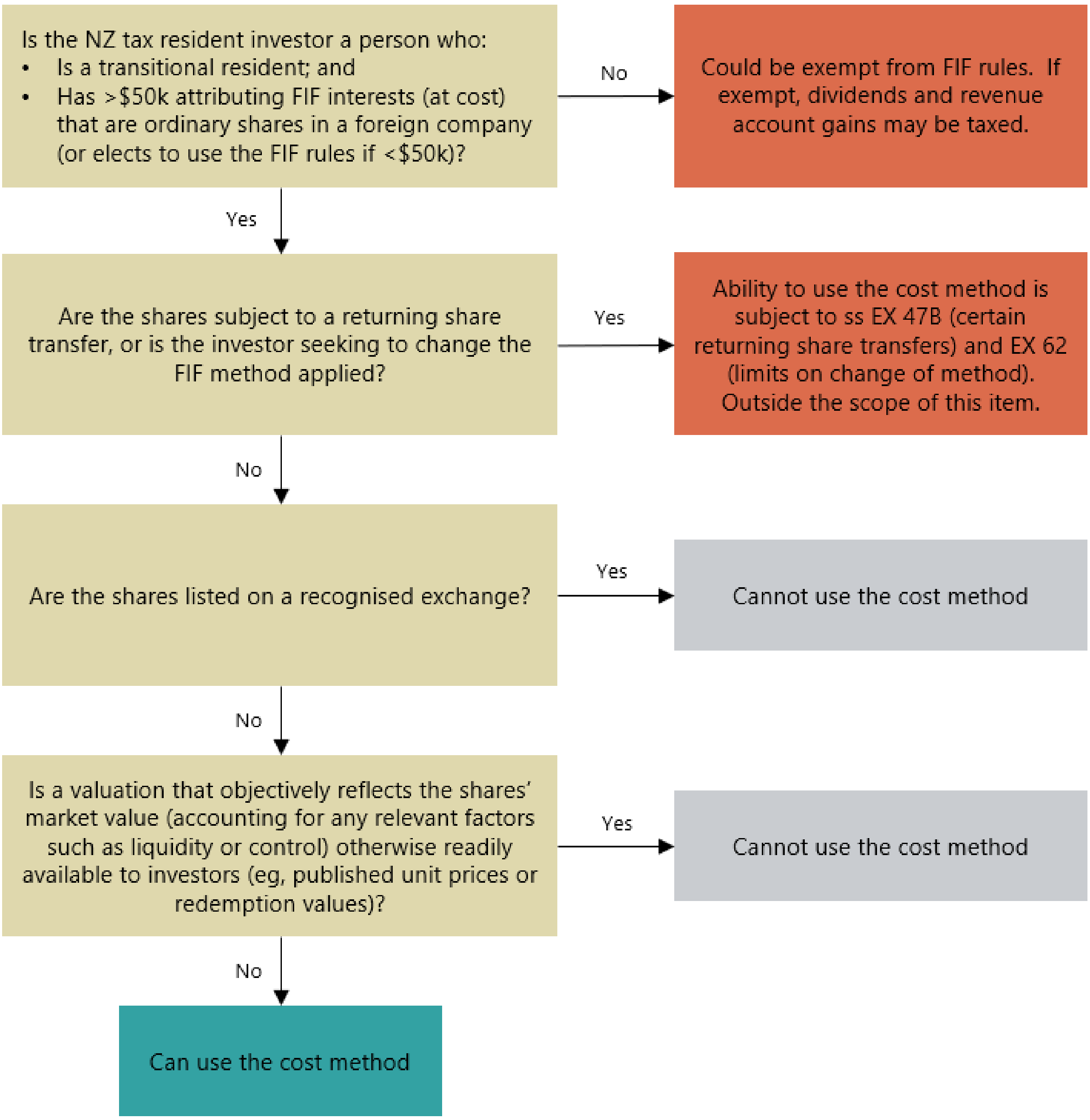
35. The Act requires foreign currency amounts to be converted to NZD to calculate a taxpayer's New Zealand income tax liability. Under the cost method, a one-off foreign currency conversion applies to the initial cost base and any further acquisitions. This means currency conversion is not required from year to year under the cost method, unless there are further acquisitions or quick sales to account for.

36. For example, under the cost method, the initial cost base of a USD denominated attributing interest can be calculated by converting the USD denominated investment to NZD at the spot rate at the date of acquisition. This converted NZD value would then be used as the preceding opening value (as defined in s EX 56(8)) in subsequent years, such that the exchange rate at the time of acquisition continues to be applied.

Flowchart | Hoahoa

37. This flowchart summarises the decision process for being able to use the cost method.

Figure | Hoahoa 1: When an investor of ordinary shares in a foreign company (which includes units in a foreign unit trust) can use the cost method



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Income Tax Act 2007, ss CQ 5, EX 28–72 (the FIF rules), YA 1 ("market value")

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Morgenstern v Jeffreys [2014] NZCA 449

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IS 25/13: Income Tax and GST – forestry activities registered in the Emissions Trading Scheme

Issued | Tukuna: 7 April 2025

This interpretation statement considers the tax consequences for forestry activities registered in the Emissions Trading Scheme (ETS). The statement considers the tax consequences of receiving, selling and surrendering emissions units (NZUs), as well as the tax treatment of specific transactions involving NZUs. For general information on the ETS, see Ministry for Primary Industries Forestry in the Emissions Trading Scheme.

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

Key terms used in this statement

1. Figure | Hoahoa 1 summarises terms from the Climate Change Response Act 2002 (CCRA) that are used in this statement when considering the application of the tax provisions to forestry activities registered in the Emissions Trading Scheme (ETS). For the full definitions, see s 4 of the CCRA. For ease of reference, this statement refers to emissions units as NZUs.

Figure | Hoahoa 1 – Summary of key terms

Term	Summary
Clearing	includes felling and harvesting trees; and for an area, when the forest species on the land are cleared
Clear-felled	when trees in permanent post-1989 forestry are cleared by human activity in an area of at least 1 hectare resulting in each hectare of land having less than 30% tree crown cover
Deforestation	occurs when forest land is either converted to non-forest land, or when a forest is cleared and not replanted or regenerated within relevant timeframes (in many cases, 4 years) (see s 179 of the CCRA)
Forest land	is land of at least one hectare with tree crown cover from forest species of more than 30% in each hectare
Forest species	are trees capable of reaching five meters in height at maturity where it is located (but excludes trees grown for fruit or nut crops)
Forestry activity	for post-1989 forest land, includes owning the forest land, holding a registered forestry right for the land, being a leaseholder under a registered lease of the land or being a party to a Crown conservation contract in respect of the land
New Zealand Unit (NZU)	means an emissions unit issued by the Registrar and designated as a New Zealand unit
Participant	is a person who is required or elects to be a participant in the ETS, and includes a person who acquires ETS registered post-1989 forest land
Post-1989 forest land	is primarily land that was not forest land on 31 December 1989, subsequently become forest land, and where foresters have elected to participate in the ETS. Status as post-1989 forest land is determined at the time a person applies to participate in the ETS.
Pre-1990 forest land	is land that was forested on 31 December 1989, remained forested on 31 December 2007, that was predominantly exotic forest (it does not include land that has been deforested and where NZUs were surrendered)
Removal activities	for the purposes of this statement means the removal of carbon dioxide equivalent greenhouse gases from the atmosphere through forestry activities

Introduction | Whakataki

2. Emissions trading is a tool to encourage and enable the reduction of greenhouse gas emissions contributing to climate change. The ETS is a market managed by the government with the objective of assisting New Zealand to meet its international obligations and its 2050 target and emissions budgets. The ETS covers about half of all emissions in New Zealand including from fossil fuel, industrial processes and waste.
3. Participants that generate greenhouse gases need to surrender one NZU to the Government for each whole tonne of carbon emissions from their relevant activities.[1] This is referred to in this statement as the participant's emissions liability.
4. The number of NZUs available to the market reduces over time, which should cause prices to rise, incentivising participants to find ways to reduce their emissions. Participants can decide whether to cut their own emissions or effectively pay others to reduce emissions by buying NZUs.
5. NZUs can be bought at government auctions or through the secondary market, including from people or entities with forestry activities (referred to in this statement as foresters) that earn NZUs for removal activities.
6. Foresters with post-1989 forest land are not required to participate in the ETS, but they may choose to do so. Where a forester chooses to participate, their forestry activities generate NZUs for removal activities. They may have obligations to report emissions and surrender NZUs when they clear a forest, deforest forest land or deregister from the ETS.[2]
7. This statement considers the income tax and GST issues that arise for foresters who have their forestry activities registered in the ETS. This statement is limited to considering tax issues arising from participating in the ETS and does not consider other tax issues that arise for the forestry sector more generally, or general issues with the ETS.

Further information

8. For general information on the ETS, see the following resources:
   - Environment Protection Authority webpage Emissions Trading Scheme
   - Ministry for the Environment webpage New Zealand Emissions Trading Scheme
   - Ministry for Primary Industries webpage Forestry in the Emissions Trading Scheme
   - Leining, C A Guide to the New Zealand Emissions Trading Scheme: 2022 update (Motu, 2022).

Guide to using this statement

9. This statement first summarises how the ETS applies to forestry activities and introduces the ETS concepts relevant for tax purposes. This includes the types of forests that may be registered, which give rise to different types of NZUs for tax purposes. For a summary, see Figure | Hoahoa 2.
10. The statement then explains the general income tax treatment of NZUs in the forestry context. This includes the tax treatment of NZUs when received, held, sold or surrendered for emissions liabilities. The statement also discusses what deductions may be available for different types of NZUs. For a summary, see Figure | Hoahoa 3.
11. The statement also considers specific events or transactions involving NZUs:
    - forestry rights agreements including the transfer of NZUs (see from [83]);
    - deregistering from the ETS or changing forestry activities (see from [90]);
    - sales of ETS registered forests including purchase price allocation (see from [108]); and
    - arrangements involving NZUs (see from [139]).
12. Finally, the statement briefly comments on GST (see from [162]).

1 Section 63 of the CCRA.

2 Sections 54, 56, 57, 64, 186A, 186C of the CCRA.

How the ETS applies to forestry activities

13. To understand the income tax consequences for NZUs earned by foresters, it is important to first be aware of how the ETS applies to forestry activities. Concepts in the CCRA and the ITA 2007 are linked.

14. Under the CCRA, a person with a forestry activity:
    - must be a participant if they deforest pre-1990 forest land (sch 3, part 1 or 1A) or if they acquire post-1989 forest land that is ETS registered; or
    - may choose to be a participant for a forestry activity that is standard forestry or permanent forestry on post-1989 forest land (schedule 4, part 1 or 1A).

15. The concepts of pre-1990 forest land and post-1989 forest land are vital to how the ETS applies to the particular forest land, and in turn to how the ITA 2007 applies to the NZUs.

Pre-1990 forest land

16. The ETS uses 1 January 1990 as a starting point for measuring changes in forest growth, so a distinction exists in the treatment of forest land established before or after that date. This was a result of New Zealand adopting international climate change agreements.[3]

17. Land that qualified as forest land on 31 December 1989, remained forest land on 31 December 2007 and was predominately exotic forest on that date is known as "pre-1990 forest land". It does not include certain types of land (such as land that was deforested and any emissions liability met).

18. When the ETS was introduced with effect from 1 January 2008, foresters with eligible pre-1990 forest land could apply for the forest land allocation plan and received NZUs in two tranches (on approval and in 2013). These foresters do not receive any further NZU entitlements for the growth of the forest and are not liable for surrendering NZUs unless their forest land is deforested.[4]

Post-1989 forest land

19. Post-1989 forest land is land that is currently forest land and is primarily land on which forest was first established after 31 December 1989. It includes land that:
    - was not forest land on 31 December 1989;
    - was forest land on 31 December 1989 but was deforested before 31 December 2007; or
    - was pre-1990 forest land but was deforested after 1 January 2008 and a liability to surrender NZUs was satisfied.[5]

20. Forestry activities on post-1989 forest land do not have to be ETS registered. A forester that chooses not to participate does not receive any NZUs for removal activities but also does not have to surrender NZUs.

Standard forests

21. Post-1989 standard forests (eg, forests intended to be harvested) have two different treatments:
    - Standard forests registered in the ETS before 1 January 2023 generally use the stock change method for carbon accounting. These foresters earn NZUs based on the forest growth and must surrender NZUs to cover emissions if the carbon stock declines (eg, from harvesting).
    - Standard forests registered in the ETS from 1 January 2023 use the averaging method for carbon accounting. [6] These foresters earn NZUs as the forest grows on its first rotation, up to the long-term average age.[7] They do not earn further NZUs for subsequent rotations. These foresters usually only need to surrender NZUs if the land is deforested or if they deregister from the ETS.

3 United Nations Framework Convention on Climate Change (UN Doc A/AC.237/18 (Part II)/Add.1; 31 ILM 849, 1992), the Kyoto Protocol (UNFCCC, Kyoto Protocol to the United Nations Framework Convention on Climate Change (UN Doc FCCC/CP/1997/7/Add.1, December 1997)), and the Paris Agreement (UNFCCC, Adoption of the Paris Agreement (UN Doc FCCC/CP/2015/L.9/Rev/1, 12 December 2015)).

4 Foresters had an option to apply for an exemption from deforestation liabilities if they owned less than 50 hectares of forest. Otherwise, deforestation liabilities arise under Part 5, subpart 2 and sch 3, part 1 and 1A of the CCRA.

5 Section 4 of the CCRA.

6 There was an opportunity for forests registered between 1 January 2019 and 31 December 2022 to change to averaging.

7 This depends on the forest type and clearance age.

22. The difference between the two methods is essentially that averaging accounts for emissions and removals by reference to the expected long-term average level of carbon stock over multiple rotations rather than by referring to short term changes in the actual carbon stock which is the method used in stock change accounting.

Permanent forests

23. From 1 January 2023, new permanent forest rules were introduced. These rules replaced the previous Permanent Forest Sink Initiative (PFSI) under the Forests Act 1949, which was removed on 1 January 2024.
24. Permanent forestry uses the stock change carbon accounting method, so NZUs are earned based on the ongoing growth of the forest.
25. When registered as a permanent forest, the land must not be clear-felled or deforested. Limited clearing of permanent forests is permitted but NZUs must be surrendered for any carbon stock loss. There are also restrictions on changing from registration as a permanent forest, and approval must be sought. Pecuniary penalties apply under the CCRA for clear-felling or deforesting permanent forests.
26. The permanent forestry period is an initial period of 50 years. After the initial 50-year period ends, the forester must choose whether to:
    - remain in permanent forestry for a further 25-year period (and continue to earn NZUs); or
    - remove the land from permanent forestry either by deregistering from the ETS or moving the forest into standard forestry and use averaging accounting.
27. If the option is taken to move the forest into standard forestry, the forester needs to surrender any NZUs earned above the long-term average. If the option is taken to deregister from the ETS, the forester needs to surrender the NZUs earned for the forest land.

Permanent forest sink initiative (now discontinued)

28. Under the PFSI, a covenant was registered against the land title and provided foresters a right to terminate after a certain number of years (with surrender of NZUs).
29. Until 1 January 2024, PFSI participants could choose to opt into the ETS as a standard post-1989 forest using averaging accounting, or a permanent post 1989-forest. If no decision was made by 1 January 2024, the participants were moved into permanent forestry. If the PFSI participant moved to standard forestry and if they had carbon stock above the average, they needed to surrender any excess NZUs.

Difference between clearing and deforestation

30. As noted above, surrender liabilities can arise on clearing post-1989 forests that use stock-change accounting and for all deforestation (pre-1990 forests and post-1989 forests).
31. Clearing occurs where the forest species are harvested or felled over an area of land. Under stock-change accounting, an emissions liability arises if the carbon stock declines (which needs to be met when the emissions return is submitted). There are exclusions for temporary clearing arising from adverse events. While a permanent forest may not be clear-felled, limited clearing is permitted but NZUs must be surrendered for any carbon stock loss (reported in an emissions return).
32. Generally, deforestation occurs when forest land is converted to another land use, or if a forest is cleared and not re-established in time. Deforestation is deemed to occur on the date that the first action is taken that is inconsistent with the land being forest land or when re-establishment tests are not met (4, 10, or 20 years after clearance).[8]
33. However, both pre-1990 and post-1989 forest land is treated as not being deforested in some cases. For example, land is not treated as being deforested if cleared land is contiguous with the edge of the forest land, is less than 1 hectare or 30 metres wide, and is required to be cleared as part of New Zealand's best practice forest management.
34. Example | Tauira 1 illustrates the different NZU earning and surrender liabilities that arise for different types of forests.

8 Section 179 of the CCRA.

Example | Tauira 1 – NZU surrender obligations for different types of forests

Tony's Timber Ltd owns several ETS registered forests.

Forestry Block A is pre-1990 forest land. Tony's Timber Ltd received NZUs in a forest land allocation plan. The timber was harvested, and the forest was replanted for a second rotation. Tony's Timber Ltd did not need to surrender NZUs at the time of harvest but would need to surrender NZUs if the land is subsequently deforested.

Forestry Block B is ETS registered as a standard post-1989 forest using stock change carbon accounting. Tony's Timber Ltd earns NZUs in accordance with the growth of the forest. When this forest is harvested, Tony's Timber Ltd must surrender NZUs. If Forestry Block B is replanted for a second rotation, those trees will earn NZUs as they grow.

Forestry Block C is ETS registered as a standard post-1989 forest using averaging carbon accounting on its first rotation. Tony's Timber Ltd will earn NZUs up to the nominal average carbon stock, but after that date no further NZUs will be earned, including for subsequent rotations. Generally, an NZU surrender liability will only arise if Tony's Timber Ltd deforests or deregisters from the ETS.

Forestry Block D is ETS registered as post-1989 permanent forestry using stock change accounting. Tony's Timber Ltd will earn NZUs in accordance with the growth of the forest. This forest may not be clear-felled for at least 50 years. There will be NZU surrender liabilities if the carbon stock declines. Following the end of the 50-year period, Tony's Timber Ltd will need to decide whether to continue in permanent forestry for another 25 years, move to averaging which triggers surrender liabilities or exit the ETS, which will also have surrender liabilities.

Types of NZUs earned from forestry activities

35. NZUs that are generated by foresters for removal activities are classed as "forest land emissions units" under s YA 1 of the ITA 2007 (forest land NZUs). A forest land NZU is a:
    - pre-1990 forest land emissions unit (pre-1990 forest land NZU);
    - post-1989 forest land emissions unit (post-1989 forest land NZU); or
    - forest sink emissions unit (now discontinued).
36. These types of NZUs have special rules for income tax purposes.
37. Under the ITA 2007, a pre-1990 forest land NZU is an NZU that is transferred to the person under part 4, subpart 2 of the CCRA and that has been held continuously by that recipient or a party to a forestry rights agreement.
38. Other than in specific contexts (forestry rights agreements and security arrangements for pre-1990 NZUs that are subject to s EW 52B of the ITA 2007) no rollover relief is provided for transfers of these types of NZUs to other parties (including transfers to partners of a partnership). This means that, generally, if pre-1990 forest land NZUs are transferred by a forester to another party, they will lose that status for income tax purposes and be treated the same as standard NZUs (like those acquired at auction or from the secondary market).
39. Under the ITA 2007, a post-1989 forest land NZU is an NZU that is transferred to the person under s 64 of the CCRA for growing trees on post-1989 forest land and that is held continuously by that recipient or a party to a forestry rights agreement. Other than in the context of a forestry rights agreement, no rollover relief is provided for transfers of these types of NZUs to other parties. If post-1989 forest land NZUs are transferred to another party, they will lose that status for tax purposes and be treated the same as standard NZUs (like those acquired at auction or from the market).
40. A specific category of NZUs is referred to in s YA 1 of the ITA 2007 as "replacement forest land emissions units". This is an NZU that the person acquired if they:
    - previously disposed of a post-1989 forest land NZU (other than through surrender under the CCRA); and
    - have not acquired another NZU to replace the NZUs that were disposed of.
41. There is no specific timing requirement for an acquisition of an NZU to qualify as a replacement forest land NZU. That is, the NZU does not have to be acquired to satisfy an imminent liability. The forester must simply have sold (or disposed of other than by way of surrender) post-1989 forest land NZUs and not have acquired another NZU that replaces it. In that case, an NZU acquired by the forester is a replacement forest land NZU.

42. Given the different types of forest land NZUs for tax purposes, foresters need to keep records of the types of NZUs they hold for tax purposes, and for example, could use separate inventory records for each type of NZU. The emissions unit register does not separately identify some types of NZUs held (because some of these are tax concepts) but NZUs are uniquely identified so can be held separately to be able to show their treatment for tax purposes. It is recommended that foresters hold different types of NZUs separately for tax purposes, to be able to show whether a particular tax treatment is available.

43. The above discussion is summarised in Figure | Hoahoa 2.

Figure | Hoahoa 2 – Features of NZUs from forestry activities

Type of NZUs	Features
Pre-1990 forest land NZUs	**Pre-1990 forest land** is land that was forested on 31 December 1989, remained forested on 31 December 2007, and was predominantly exotic forest at that later time. (It does not include land that has been deforested). These NZUs were allocated to foresters under the Forest Land Allocation Plan. No further allocations are made for future growth of these forests. These NZUs must remain held continuously by the original recipient (or a party to a forestry rights agreement) otherwise they lose their tax status.
Post-1989 forest land NZUs	**Post-1989 forest land** is primarily land that was not forest land on 31 December 1989. These NZUs are transferred to a forester under s 64 of the CCRA for removal activities. The NZUs are allocated to foresters over time (depending on the carbon accounting method used). These NZUs must remain held continuously by the original recipient (or a party to a forestry rights agreement) otherwise they lose their tax status.
Replacement forest land NZUs	These NZUs are acquired by a forester who has previously sold post-1989 forest land NZUs and has not previously acquired other NZUs to replace the post-1989 forest land NZUs that were sold.
Standard NZUs	All other NZUs a forester acquires, or any of the above types of NZUs that have lost their status (eg, because they have been transferred to another person).

General income tax treatment of NZUs

44. This part of the statement explains how the ITA 2007 applies to a forester's receipt and disposal of NZUs.

Receipt of forest land NZUs for removal activities

45. When pre-1990 forest land NZUs were allocated to foresters, at the time of allocation the receipt of those NZUs was exempt income under s CW 3B provided the land was held on capital account.

46. Where an ETS registered forester receives post-1989 forest land NZUs for removal activities (whether using the stock change or averaging accounting method), those NZUs would generally be income derived from the forestry activity. However, there are no tax consequences for the forester in the year of receiving the NZUs for removal activities. Instead, taxable income is delayed until the forester sells the NZUs. This treatment is confirmed in s ED 1(7B).

47. The matching rules in subpart ED apply to revenue account property that is an excepted financial arrangement. Revenue account property is defined in s YA 1 as property that if disposed of for consideration would produce income, and specifically includes an emissions unit. An emissions unit is an excepted financial arrangement under s EW 5(3B) (so is not subject to the financial arrangements rules). Therefore, NZUs are subject to subpart ED.

48. When a person has an NZU, its value at the end of the income year is income under s CH 1 and its value at the beginning of an income year is deductible under s DB 49. Section ED 1(1) is the general rule for determining that value. That section provides that NZUs are generally valued at cost at the end of each income year. However, there are specific rules that apply to forest land NZUs.

49. Section ED 1(7B) applies to forest land NZUs and specifies a value at the time of receipt, and at the end of the year, of zero.

50. Where foresters hold their forest land NZUs over several income years, there are no income tax consequences. As noted above, s ED 1(7B) provides that the value of a forest land NZU is zero at the end of the income year. This value is relevant for determining an amount of income at the end of the year (s CH 1) which would be zero, and the amount of deduction at the beginning of the next income year (s DB 49) which would also be zero.

51. Therefore, there are no income tax consequences for a forester in the income year in which they earn NZUs for removal activities, or when they continue to hold those NZUs at the end of an income year.

Sale of NZUs

52. Under s CB 36, amounts derived from the disposal of NZUs are income. Therefore, if a person sells an NZU, the amount received from that sale is generally taxable.

53. Recent amendments to s GC 1 mean there is generally no requirement that the NZUs must be treated as sold for market value if the transaction occurs in the course of carrying on a business and does not occur between associated persons.[9]

54. However, the amount derived from a sale is not taxable in certain situations involving pre-1990 forest land NZUs. This is where:

- the NZU is a pre-1990 forest land NZU and the forest land is held on capital account (the amount is excluded income under s CX 51B); or
- the amount is derived from a transfer of a pre-1990 forest land NZU under a lending arrangement subject to s EW 5(11C) (the amount is excluded income under s CX 54B).

55. In the context of a forest land NZU, because no cost was incurred in acquiring the NZU, the full amount received on a sale is taxable income and no deduction is available. Foresters are specifically disallowed a deduction for their emissions liabilities under ss DB 60 and DB 60B, discussed below.

Surrender of NZUs

56. When a disposal of NZUs occurs through surrender under the CCRA, rather than a sale, s CB 36 contains a series of rules deeming what the amount of income is treated as being in each situation.

57. Under s 63 of the CCRA, an ETS participant is liable to surrender one NZU for each whole tonne of emissions from the relevant activity, as calculated under the CCRA. For example, foresters will have emissions liabilities where they:

- deforest pre-1990 forest land;
- use averaging accounting and deforest post-1989 forest land;
- use stock change accounting and clear a forest on post-1989 forest land; or
- have reductions in the carbon stock in a permanent post-1989 forest.

58. For present purposes, if a person disposes of their NZUs by way of surrender under the CCRA, they are treated as having sold the NZU for a value specified under s CB 36. If no specific provisions apply, the value is treated as being the cost of the NZU.

Specific types of surrender

59. A forester is treated as selling an NZU for a value of zero if they surrender the NZU:

- in relation to post-1989 forest land; or
- for deforestation of pre-1990 forest land where the land is held on revenue account.

60. A forester is treated as selling an NZU for market value if a post-1989 forest land NZU is surrendered other than for emissions relating to post-1989 forest land.

9 Associated persons are defined in ss YB 1 to YB 16 of the ITA 2007.

Surrender of pre-1990 forest land NZUs for post-1989 forest land liabilities

61. If pre-1990 forest land NZUs are surrendered to meet a post-1989 forest land liability, special rules apply (s DB 61). In this situation, the person is treated as having:

- disposed of the pre-1990 forest land NZUs to an unrelated person immediately before the surrender; and
- having then reacquired the NZUs immediately before the surrender;

in both cases for an amount equal to the NZU's market value at the time.

62. The result of s DB 61 applying is as follows:

- Pre-1990 forest land NZUs are treated as being sold to a third party for market value immediately before surrender. This market value amount will be exempt income if the land was held on capital account, or taxable income if the land was held on revenue account.
- The person is treated as having reacquired the NZUs at market value at the same time. This deemed amount would form the cost of the newly acquired NZUs.
- The person then surrenders the NZUs in relation to post-1989 forest land. Section CB 36 treats this as occurring for zero value, so there is no income.
- The surrender of the NZUs is a disposal of the NZUs. This event triggers the available deduction for cost under the revenue account property rules.

63. Therefore, if the land in respect of which the pre-1990 forest land NZUs were granted was held on capital account, the person has no income on the deemed sale at market value, no income on the surrender of the NZUs, and a market value deduction for the cost of the new NZUs on disposal. Ultimately, the forester in this situation receives a net deduction, similar to any other person who has to acquire NZUs for surrender.

64. If the land in respect of which the pre-1990 forest land NZUs were granted was held on revenue account, this treatment results in income on the deemed sale at market value, no income on the surrender of the NZUs, and then a market value deduction for the cost of the new NZUs on disposal. Ultimately this forester is in a neutral tax position (because the deductible cost of the new NZUs is deemed to be the same value as the income on deemed disposal).

What deductions are available

65. The availability of a deduction for the acquisition of an NZU depends on the type of NZU acquired.

Forest land NZUs

66. Under s DB 60, where NZUs are transferred to foresters for removal activities, pre-1990 forest land, or under a permanent forest scheme, the forester is not allowed a deduction for any expenditure or loss incurred as consideration (if any) for the NZUs. Therefore, there is no deduction for the 'cost' of acquiring these NZUs.[10] For completeness, the denial of a deduction relates to costs incurred in consideration for the NZUs, and not, for example, costs associated with maintaining the forest.

67. Section DB 60B provides that a forester who is liable for emissions (eg, due to clearing or deforestation) is denied a deduction for that liability.

68. Therefore, a forester does not have any deductions in respect of NZUs earned for removal activities. They do not receive a deduction for the cost of the NZU on sale or surrender because the NZUs are valued at zero for tax purposes. They also do not receive a deduction for any emissions liabilities.

Purchased NZUs

69. Generally, under the matching rules in subpart ED, a deduction is not available at the time of acquisition for the acquisition cost of NZUs. Instead, the deduction is deferred until the NZUs are disposed of (eg, by way of sale or surrender). However, different treatment applies for purchased NZUs that are replacement forest land NZUs.

10 Section 64 of the CCRA applies in relation to the issue of NZUs to foresters for removal activities. Part 4, subpart 2 of the CCRA related to pre-1990 forest land units.

Replacement forest land NZUs

70. A "replacement forest land emissions unit" is an NZU that the person acquired if they:
    - previously disposed of a post-1989 forest land NZU (other than through surrender under the CCRA); and
    - have not previously acquired another NZU to replace the NZUs that were disposed of.
71. Deductions for the cost of these NZUs can be claimed at the time of acquisition. Effectively, this recognises that the disposal of the post-1989 forest land NZUs (other than by way of surrender) would have resulted in taxable income to the forester. The key factor is that the NZUs are acquired to replace post-1989 forest land NZUs that were disposed of, and no previous replacements have been acquired since the disposal.
72. If a forester has acquired replacement forest land NZUs, the deductibility of the acquisition cost of these NZUs would fall under ordinary principles. Generally, this would be deductible as an expense incurred in carrying on a forestry business for the purpose of deriving income under s DA 1.
73. A replacement forest land NZU is valued at zero at the end of the year (s ED 1(7B)). The difference with other forest land NZUs is that in this case the forester has paid an amount to acquire the replacement NZU (and a deduction for that cost is not disallowed under s DB 60). Therefore, the revaluation of the replacement NZU to zero at the end of the year means the deduction is generated in the year of purchase under the matching rules. That is, the deductible cost is the amount the person paid to acquire the NZU, and the income at the end of the year to offset that cost is zero. This treatment applies only for NZUs that meet the definition of a replacement forest land NZU.
74. For example, the following scenarios would not qualify as replacement forest land NZUs:
    - purchasing more NZUs where post-1989 forest land NZUs had not been sold or where replacement NZUs have already been acquired;
    - acquiring land or a forest with an emissions liability, where the forester is required to purchase NZUs for that emissions liability; or
    - the sale of pre-1990 NZUs and acquisition of NZUs to satisfy an emissions liability.

Summary of general tax treatment of NZUs

75. Generally, for pre-1990 forest land NZUs, as long as the land was held on capital account, there are no tax consequences for holding or disposing of these NZUs.
76. For post-1989 forest land NZUs, there is no tax liability in the year of receipt (or while they remain on hand) as these NZUs are treated as being valued at zero while they are held by the forester.
77. There is a tax liability for the sale of post-1989 forest land NZUs on the full amount received for the sale. There is no deduction for the cost of the NZUs (as they are held at zero), so the full sale proceeds are taxable.
78. There is no tax liability when NZUs are surrendered for emissions liabilities under the CCRA. Generally, this is deemed to occur for a value of zero (when surrendered in relation to post-1989 forest land).
79. Generally, no deductions are available to foresters for any costs of forest land NZUs they earn for removal activities, or for their emissions liabilities. A forester can receive a deduction in the year of purchase only if they acquire replacement forest land NZUs. In other cases where a forester buys NZUs, but which are not replacement forest land NZUs, the deduction is delayed until disposal.
80. A summary of the general tax treatment is provided in Figure | Hoahoa 3.

Figure | Hoahoa 3 – Summary of tax treatment of NZUs for forestry activities

Type of NZUs	Acquisition and year end	Surrender	Sale or transfer	Timing of deductions
Pre-1990 forest land NZUs	On allocation, NZUs were exempt income. Valued at zero at the end of the income year.	Generally, no income tax consequences on surrender, as valued at zero when surrendered. If surrendered for post-1989 forest land, special rules apply (see from [61]).	If the land is held on capital account, the amount received from the sale of NZUs is excluded income. If the land is held on revenue account, the amount received from the sale of NZUs is taxable.	No deductions are available.
Post-1989 forest land NZUs	No income tax consequence in the year of receipt. Valued at zero at the end of the income year.	No income tax consequences on surrender, as valued at zero when surrendered for post-1989 forest land.	The amount received from a sale is taxable.	No deductions are available.
Replacement forest land NZUs	These NZUs are purchased. Valued at zero at the end of the income year.	No income tax consequences on surrender, as valued at zero when surrendered for post-1989 forest land.	To qualify as replacement forest land NZUs these are acquired to replace post-1989 NZUs and would be required for surrender However, if sold the amount received is taxable.	The cost of purchasing NZUs is deductible. A deduction for the cost of these NZUs is available in the income year in which purchased.
NZUs acquired on the market or at auction includes forest land NZUs that lose their status due to transfer	These NZUs are purchased. Valued at cost at the end of the income year.	Valued at zero when surrendered for post-1989 forest land	The amount received from a sale is taxable.	The cost of purchasing NZUs is deductible. A deduction for the cost of NZUs is available only at the time of disposal (surrender or sale).

81. The above concepts are illustrated in Example | Tauira 2 and Example | Tauira 3.

Example | Tauira 2 – Harvest of post-1989 forest (stock change accounting)

Fiona's Forestry Ltd owns an ETS registered standard post-1989 forest and uses stock change carbon accounting. The forest is 28 years old and is harvested in January 2024.

Fiona's Forestry Ltd received 10,000 NZUs for removal activities. These NZUs were separately identified in Fiona's Forestry Ltd's accounts as being post-1989 forest land NZUs. The receipt of these NZUs is valued as being zero at the end of each income year up until the year of disposal.

Fiona's Forestry Ltd was required to surrender 8,000 NZUs for emissions liabilities at the time of harvest. The 8,000 post-1989 forest land NZUs surrendered are deemed to be sold for zero. No deductions are available in respect of the cost or surrender of the NZUs or for any emissions liabilities.

The remaining 2,000 NZUs were sold on the market. An NZU had a market value of $64 at the time of sale.

Fiona's Forestry Ltd will have an income tax liability for the year ended 31 March 2024 in relation to the amounts received from the sale of 2,000 NZUs on the market, which was $128,000. The full amount received is taxable because no deductions are available for the cost of the NZUs.

Example | Tauira 3 – Replacement forest land NZUs

Ray's Radiatas Ltd owns an ETS registered standard post-1989 forest and uses stock change carbon accounting. The forest is 18 years old as at February 2024 and is not due to be harvested for several years.

Ray's Radiatas Ltd received 16,000 NZUs for removal activities. These NZUs were separately identified in Ray's Radiatas Ltd's accounts as being post-1989 forest land NZUs. The receipt of these NZUs is valued as being zero at the end of each income year up until the year of disposal.

Ray's Radiatas Ltd needed funds, so sold half these NZUs on the market. An NZU had a market value of $64 at the time of sale.

In March 2024, 8,000 NZUs were sold for $512,000. Ray's Radiatas Ltd will have an income tax liability for the year ended 31 March 2024 in relation to this amount. The full amount received is taxable because no deductions are available for the cost of the NZUs.

Before harvest, Ray's Radiatas Ltd needs to acquire enough NZUs to fund its emissions liability. Those NZUs will be replacement forest land NZUs (which Ray's Radiatas Ltd will hold in a separate account from its post-1989 forest land NZUs). In the income year of acquiring the replacement forest land NZUs, a deduction is available for the cost of those NZUs.

In the income year of surrender, the NZUs surrendered (whether they are post-1989 forest land NZUs or replacement forest land NZUs) will be treated as being sold for an amount of zero and no income tax liability will arise.

Specific events or transactions

82. This part of the statement considers common transactions and events that may arise for foresters who have ETS registered forestry activities. These transactions and events are:

- forestry rights agreements;
- deregistering from the ETS and changing forestry activities;
- sales of ETS registered forests, along with NZUs; and
- sale and repurchase agreements for NZUs and off-take arrangements.

Forestry rights agreements

83. Under the Forestry Rights Registration Act 1983, a landowner can grant a forestry right to themselves or a third party.

84. The forestry right may be to establish, maintain and harvest a crop of trees on the land. The forestry right may also grant access rights and the use of tracks and bridges. It may also provide for charges, payments, royalties or division of the crop, including the right to receive and obligation to surrender NZUs.

85. Under these agreements, only one party (either the landowner or the rights holder) can register under the ETS and receive the NZUs generated by the forest and be liable for any emissions. The parties to such an agreement should ensure the rights and obligations regarding NZUs are covered in that agreement. Section 182A of the CCRA specifies that only the landowner of the land, the holder of a registered forestry right or the leaseholder of a registered lease may be registered as an ETS participant. Where a forestry rights agreement exists, both parties must agree in writing which relevant party is to register as the participant.

86. Where a person is a rights holder under a forestry rights agreement, they can receive a transfer of NZUs from the other party in accordance with the agreement without tax consequences. The s YA 1 definition of a "post-1989 forest land emissions unit" includes an NZU that is transferred by one party to the other party to a forestry rights agreement, where the transfer occurs under a provision of the forestry rights agreement relating to the allocation of income or emissions units between the parties. This means that, unlike other disposals, a post-1989 forest land NZU retains its status when transferred in accordance with a forestry rights agreement. Therefore, the provisions applying to post 1989 forest land NZUs (as discussed earlier) also apply to transferees under a forestry rights agreement.

87. The disposal of an NZU under a forestry rights agreement is subject to s CB 36. Generally, any amount received for that disposal is income to the transferor of the NZU. However, if the NZUs are transferred for no amount in accordance with the forestry rights agreement, no deemed income arises under s GC 1. This is because s GC 3B excludes from s GC 1 the transfer of a forest land NZU to a party to a forestry rights agreement as required by that agreement.

88. For completeness, entering into forestry rights agreements has income tax consequences more generally (other than in relation to ETS issues) and parties to such agreements should seek advice.

Example | Tauira 4 – Forestry rights agreement

Farmer Frank Ltd has three farms across the North Island that contain several hectares of marginal farmland unsuitable for grazing. Farmer Frank Ltd enters into a forestry rights agreement with Cara's Carbon Farm Ltd, under which Cara's Carbon Farm Ltd will establish, maintain and harvest the forests on that land. The agreement specifies that Cara's Carbon Farm Ltd is the relevant ETS participant.

Under the forestry rights agreement, Cara's Carbon Farm Ltd will pay Farmer Frank Ltd for the grant of the forestry right, and Cara's Carbon Farm Ltd will receive all NZUs and be liable for any ETS obligations.

If the land was already ETS registered prior to the forestry right being granted, and any NZUs are transferred in accordance with the forestry rights agreement for no consideration, they retain their status as post-1989 forest land NZUs and no income tax obligations arise from the transfer of those NZUs.

Deregistration and changing forestry activities

89. Various surrender obligations arise under the CCRA when a forester changes their activity, whether they deregister all or part of their land from the ETS, change the type of forestry activity they are undertaking, or change their carbon accounting methods.

Deregistering from the ETS

90. Section 186 of the CCRA applies when a person ceases participation in a forestry activity. This section applies whether the person is ceasing to be a participant in the ETS altogether or is removing a particular area of land or part of an area from the ETS.[11] The person is liable to surrender the number of NZUs equal to the unit balance of the area that is removed from the ETS.[12]

11 A participant could remove a whole carbon accounting area (CAA) or part of a CAA (s 186B and 186D CCRA). Where there is a part removal, there may be emissions liabilities and also a requirement to surrender the unit balance for that area.

12 Section 186A of the CCRA.

91. Section CB 36 explains how to value a surrender of NZUs under the CCRA.

92. Section CB 36 provides that surrenders of NZUs for ceasing an activity in relation to post-1989 forest land (which would include partial or full deregistration from the ETS) are treated as being a sale for a value of zero.

Transferring interests

93. If an ETS registered participant transfers their forestry interest to another person, the transferor is liable for any obligations that arose while they were participant in respect of the transferred interest.[13] They must submit a final forestry emissions return up until that date.[14] The transferee will become the relevant participant from the date of transfer and will be liable for any obligations after that time.

94. Figure | Hoahoa 4 summarises the main types of transfers of interests of ETS registered forestry activities that could occur and the effect for the new participants.

Figure | Hoahoa 4 – Transfers of interests under the ETS

ETS participant	Interest transferred	New ETS participant	New forestry activity
Landowner of post-1989 forest land	Sale of post-1989 forest land	New landowner	Owning post-1989 forest land
	Grant of registered forestry right	Forestry right holder (if parties agree and MPI is notified)[15]	Holding a registered forestry right over post-1989 forest land
	Grant of registered lease	Lessee (if parties agree and MPI is notified)	Being a lessee under a registered lease of post-1989 forest land
Holder of a registered forestry right over post-1989 forest land	Transfer of registered forestry right	New forestry right holder	Holding a registered forestry right over post-1989 forest land
	Termination of registered forestry right	The landowner of the post-1989 forest land	Owning post-1989 forest land
Leaseholder under a registered lease of post-1989 forest land	Transfer of interest in registered lease	New lessee	Being the leaseholder under a registered lease of post-1989 forest land
	Termination of registered lease	The landowner of the post-1989 forest land	Owning post-1989 forest land

95. As stated previously, transfers of forest land NZUs that occur during transfers of forestry interests will generally lose their status for tax purposes (except in accordance with a forestry rights agreement). The transferred NZUs are required to be treated by the new participant in the same way as NZUs acquired from the market or at auction as previously discussed (and will generally not qualify as replacement forest land NZUs).

13 This may be referred to as a transfer of participation.

14 Section 187 of the CCRA

15 MPI administers the forestry section of the ETS under delegated authority from the EPA.

Changing forestry activities

96. In addition to deregistering from the ETS or transferring interests to another person, participants can also apply to change their activity.

97. Under s 189 of the CCRA, a participant with an activity of standard forestry or permanent forestry can apply to change to the other type of activity. A change in activity carries over the unit balance from the initial activity to the final activity and a final emissions return needs to be submitted. Different liabilities arise depending on what the initial forestry activity was and what the new forestry activity will be.

98. However, there are restrictions in a change of activity if a person is registered for carrying out permanent forestry activities. The permanent forestry period is initially 50 years with an option to renew for a further 25 years (or further consecutive periods). This does not change if the land is transferred to another person. Examples of when a person can cease being registered for a permanent forest include:
    - if the Minister of Climate Change approves;
    - because of certain natural events;[16] or
    - if a transferee takes over that permanent forestry registration.

99. After the 50-year permanent forestry period ends, the person can extend the period for 25 years or can apply to be removed from the ETS or to transfer to standard forestry. On removal from the ETS or transfer to standard forestry, there are emissions liabilities the forester must meet.

100. Emissions liabilities may also arise in other cases, for example if the type of trees grown changes (because different trees sequester carbon at different rates). This may occur if, for example, a permanent exotic forest is being transitioned into indigenous forests.

101. In these cases, there will be liabilities to surrender NZUs for emissions. As previously noted, under s CB 36, where NZUs are surrendered in relation to post-1989 forest land they are treated as being sold for zero.

Changing accounting methods

102. While most foresters with post-1989 forest land currently use stock change accounting, the averaging accounting method applies to forests registered after 31 December 2022. This carbon accounting method accounts for emissions and removals by reference to the expected long-term average level of carbon stock of the land over multiple rotations rather than by referring to short term changes in the actual carbon stock which is the method used in stock change accounting.[17]

103. Prior to 30 June 2023, a participant using stock change accounting could opt into averaging accounting for carbon accounting areas where the first ETS registration had occurred after 1 January 2019.[18] These participants needed to file an emissions return specifying the emissions and removals during the period and calculating the liability or entitlement as if they had used averaging during the period. If the difference was positive the person received additional NZUs. If the difference was negative the person must surrender those NZUs.

104. Permanent forests that move into standard forestry are required to apply averaging accounting.

105. As with the above, there will be liabilities to surrender NZUs for emissions resulting from any change in carbon accounting treatment. As previously noted, under s CB 36, where NZUs are surrendered for emissions for post-1989 forest land they are treated as being sold for zero.

Summary

106. The CCRA establishes the consequences for a forester deregistering from the ETS, transferring interests, swapping between categories, or changing accounting methods. In these cases, often a final emissions return is required with the CCRA specifying calculations for the amount of NZUs that may need to be surrendered (and in some cases any penalties).

107. In these cases, the surrender is deemed to occur for a value of zero under s CB 36. Whether the NZUs surrendered are forest land NZUs, replacement forest land NZUs or standard NZUs determines what deductions may be available and the timing of those deductions (as discussed earlier in this statement).

16 Section 182G of the CCRA.

17 Section 191A of the CCRA.

18 Clause 33 of schedule 1AA of the CCRA.

Sales of forests – purchase price allocation rules

108. The purchase price allocation rules in ss GC 20 and GC 21 require parties to a sale and purchase of a forest along with other assets to adopt the same allocation of the purchase price to the various classes of assets sold. These rules do not apply if the sale of the forest does not contain different classes of assets (for example if there was a sale of a forestry right with the only asset sold being standing timber).

Summary of the purchase price allocation rules

109. Section GC 20 applies where the parties have agreed how the consideration will be allocated. Section GC 21 applies where the parties have not agreed on allocation and a unilateral allocation is made.[19]

110. Sections GC 20(1) and GC 21(1) provide that the sections apply when, for consideration, a vendor disposes of items of property to a purchaser that fall into two or more classes of purchased property. Those classes are:
   - (i) trading stock, other than timber or a right to take timber
   - (ii) timber or a right to take timber
   - (iii) depreciable property, other than buildings
   - (iv) buildings that are depreciable property
   - (v) financial arrangements
   - (vi) purchased property for which the disposal does not give rise to assessable income for the vendor or deductions for the purchaser.

111. Under s GC 20, the parties agree and record the consideration allocated to each class of purchased property. This must occur before either party files a return in relation to the property. Each class of purchased property is treated as disposed of and acquired for the relevant allocated amount.

112. Section GC 21 applies where there has not been agreement before the relevant dates. The amounts are allocated as follows:
   - The vendor may notify the purchaser and the Commissioner of the allocated amounts within 3 months of the change in ownership of the property. The amounts allocated must be the greater of the relative market value of the class of property proportional to the other classes or property, or their tax book value for the relevant class of property.
   - If the vendor does not notify the allocated amounts, the purchaser may notify the vendor and the Commissioner of the relevant allocated amounts within 6 months of the change of ownership of the property. An allocated amount must reflect the relative market value of the relevant class of purchased property proportional to the other classes of property.
   - If the vendor or purchaser do not notify the relevant people as above, the Commissioner may allocate amounts to the classes of purchased property.

113. Under s GC 21(8), the purchaser is not able to allocate a deduction for the purchased property except as provided by s GC 21.

114. Section GC 20(2) and s GC 21(7) provide that a class of purchased property is treated as disposed of and acquired for the allocated amount.

115. Under s GC 20(2)(b), the Commissioner may treat a class of property as disposed of and acquired for an amount that reflects the relative market value of the class of purchased property, proportional to the other classes of purchased property, if the Commissioner considers the agreed allocated amount does not reflect that value.

Interaction with s GC 1

116. The purchase price allocation rules operate to allocate the agreed purchase price between the relevant classes of purchased property. The rules do not apply to substitute a new purchase price.

117. Section GC 1 applies to disposals of trading stock for less than market value and deems the vendor to have derived market value consideration. However, the section applies only if the parties are associated, the trading stock is taken for the vendor's own use, or the disposal of trading stock is not made in the course of carrying on a business for the purpose of deriving income.

19 Although there are some exclusions, for example if the total consideration is less than $1 million.

118. Section GC 1(5) further provides that the section does not apply to a disposal of trading stock to which s GC 20(2) or s GC 21(7) apply. Therefore, when those sections apply, it is the allocations made under the purchase price allocation rules that are relevant and no further amounts of consideration need to be accounted for.

119. However, there are exclusions to this where the transaction occurs between associated persons. Section GC 20(2B) and s GC 21(11B) specifically provide that ss GC 20(2) and GC 21(7) do not apply where property in class (i) trading stock or in class (ii) timber or a right to take timber are sold:

- between associated persons; and
- the allocated amount for the class of purchased property is less than the total market value of the items of purchased property in the class of property at the time of the disposal.

120. For completeness, there is nothing in the plain wording of s GC 1 that restricts its application to a situation where only trading stock is sold. The fact that s GC 1(5) specifically states that s GC 1 has no application where s GC 20(2) and GC 21(7) apply, indicates that s GC 1 would otherwise have applied to the transfer of trading stock as part of a wider sale of business assets. Where parties are not associated, and they make an allocation under the PPA rules, s GC 1 will not apply to increase the amount of consideration for trading stock (eg, NZUs) or timber. However, where parties are associated and market values are not allocated, then s GC 1 will apply to increase the value attached to trading stock or timber.

121. Therefore, a transaction between associated persons must allocate market value to all items of trading stock or timber or a right to take timber. If not, s GC 1 will apply to deem there to be market value consideration. Associated parties to a forestry transaction that is subject to the purchase price allocation rules should obtain a valuation to support their allocation of value to each class of purchased property.

Meaning of trading stock

122. For the purposes of s GC 20 and GC 21, "trading stock" is defined in s YA 1 as including:

- anything acquired for the purposes of manufacture or disposal;
- land whose disposal would produce income under any of sections CB 6A to CB 15 and CZ 39 (which relate to income from land);
- anything for which expenditure is incurred and would be trading stock if possession of it were taken.

123. NZUs are not ordinarily "trading stock". They are explicitly excluded from being trading stock for the purposes of the trading stock rules in subpart EB. However, the definition of trading stock is broadened in some cases.

124. Section GC 3B provides that NZUs are treated as if they were trading stock for the purposes of s GC 1. This could imply that otherwise NZUs are not trading stock (given the exclusion in subpart EB). However, the definition in s YA 1 includes "anything acquired for the purposes of … disposal". In most cases, NZUs would be acquired by a forester for the purpose of disposal. The relevant purposes generally being for surrender for emissions liabilities or for sale on the market.

125. Therefore, generally, the parties to a sale and purchase of a forest need to agree an allocation of a purchase price between (where relevant):

- NZUs (trading stock in asset class (i));
- timber or a right to take timber (asset class (ii)); and
- capital account land (asset class (iv)).

Purchase price allocation treatment of NZUs

126. Issues arise regarding how the purchase price allocation rules apply to NZUs. That is, whether parties must allocate market value to the sale of NZUs, or whether they can offset a liability to surrender NZUs for emissions.

127. Generally, a forest's fair value would be reached by calculating the discounted future cashflows from the forest. This could involve including the future NZU entitlements and the obligation to surrender NZUs on harvest (if applicable) in the value of the timber. If this valuation methodology is used, then the future obligation to surrender NZUs is accounted for in the value of the timber and cannot be used to value NZUs on hand as being nil. Those NZUs must be allocated market value.

128. However, it is not so clear how to account for NZUs when the valuation of the trees excludes any NZU entitlements and liabilities. A purchaser of a forest with NZUs may not want to pay anything to acquire NZUs that must soon be surrendered on harvest. This would factor into the agreed purchase price for the transaction. Also, post-1989 forest land NZUs are carried at a value of zero for tax (and generally also for accounting) purposes (although this treatment is not determinative for purchase price allocation purposes).

129. Several different situations can apply in the context of the sale of a forest, generally depending on what the purchaser intends to do with the forest, including the following examples:

- If the purchaser acquires or plans to register a forest as a permanent forest, the only income generated from the forest is the NZUs. Whether any emissions liability exists depends on whether the trees will be cleared after the 50 years of being in the permanent forest regime.
- If the purchaser uses averaging accounting and the land remains forest land, there will be no emissions liability (at least until the time where the land becomes unviable for further rotations).
- If the purchaser uses averaging accounting and intends to deforest, then the liability will arise on deforestation.
- If the purchaser uses stock change accounting, they will have a liability when they clear the forest.
- Where a forest is sold shortly before harvest, the surrender liabilities may be considered to no longer be contingent (if the forest uses stock change carbon accounting). If a future surrender liability is sufficiently certain to be an actual liability at the time of the purchase, for the purposes of ss GC 20 and GC 21, the liability amount may be taken into account in the total amount of consideration payable for the forest.

130. There is no single correct answer to what an appropriate purchase price allocation may be for the sale of a forest because there are many variables. It is recommended that parties obtain tax advice when undertaking a purchase price allocation and that they have sufficient supporting evidence (such as valuations) to support their allocation of value to each class of purchased property. However, where the parties to a transaction are associated, they will need to allocate market value to purchased property that is timber, a right to take timber and trading stock (such as NZUs) under ss GC 20(2B), GC 21(11B) and GC 1.

131. Illustrative examples of what may be considered appropriate allocation methods of the purchase price in particular fact situations are set out below. For the avoidance of doubt, the transactions in these examples occur between arm's length parties, and reflect commercially negotiated terms. However, each situation will depend on its facts, valuations, and on the commercial bargain reached between the parties to the transaction. The important point is that parties allocate the same values to the same purchased classes of property and that appropriate amounts are allocated between, for example, capital and revenue items.

Standing timber is valued on a discounted cash flow basis and full market value is attributable to NZUs

132. An appropriate allocation method would have standing timber valued on a discounted cash flow basis and full market value attributable to NZUs. Under this method, the NZUs to be surrendered on harvest are included in the cost of harvest (ie, it would be accounted for as a reduction in the value of the timber when the value at harvest is being calculated). If so, it would not be appropriate to value the NZUs at nil because the cost of surrender is included in the value of the timber.

Example | Tauira 5 – Emissions liabilities accounted in value of timber

Fiona's Forestry Ltd was planning to increase its forestry interests and entered a series of sale and purchase agreements to buy forestry blocks.

The first agreement was for the purchase of a standard forestry block from Timmy's Trees Ltd for total cash consideration of $100. The forest was registered using stock change accounting and would be harvestable in 10 years' time. The standing timber had been valued by a registered valuer, with reference to the emissions liability at harvest on a discounted basis.

Fiona's Forestry Ltd and Timmy's Trees Ltd agreed to a purchase price allocation of the $100 purchase price among the classes of purchased property as follows:

- class (i) trading stock (NZUs) 10
- class (ii) timber 70
- class (vi) capital account land 20

The NZUs must be attributed a market value because the value of the timber already takes into account the emissions liability at harvest.

Timmy's Trees Ltd will have income tax obligations for $80 on sale (timber and NZUs). Fiona's Forestry will be able to deduct the purchase price allocated to the timber ($70) and the NZUs ($10) at the time of disposal.

Allocate nil value to NZUs to the extent that they need to be surrendered at harvest due to purchase price negotiations

133. However, it is acknowledged that forests will not always be valued on the above basis and the Commissioner does not require a particular valuation methodology be used. A possible allocation method that may be available in some situations, depending on the facts, may be to allocate nil value to NZUs to the extent that they need to be surrendered at harvest. This is only where the purchaser is unwilling to pay for the NZUs that would be required for surrender, which are effectively offset by the future liability on the purchaser to surrender those NZUs.

134. This option may be available in some situations where, as part of the commercial negotiations, the purchaser is not willing to pay an amount for the NZUs required for surrender and this is reflected in the total purchase price paid. The parties will need to be able to provide sufficient evidence supporting their allocations. This could include details of the negotiations, the valuations of the land and timber and may be supported by accounting treatment. In this situation, the purchase price amount would need to be consistent with the valuation of the timber and land excluding NZUs.

135. This allocation is not appropriate if amounts allocated to the trees take into account ETS liabilities. Whether or not NZUs must be allocated a separate value is entirely dependent on the valuation of the trees. The Commissioner does not intend to provide advice on which valuation methodologies are or are not appropriate, as that is a commercial matter.

Example | Tauira 6 – Imminent liability offset against NZU value

Fiona's Forestry Ltd entered a second sale and purchase agreement with Timmy's Trees Ltd to acquire a second standard forestry block for total cash consideration of $120.

This forestry block was also registered as a standard forest using stock change accounting. This forest was harvestable in 1 year. Fiona's Forestry Ltd planned to harvest and then replant with indigenous species and register the forest in the permanent forestry regime.

The valuer for this forest did not take into account ETS obligations when valuing the timber. Fiona's Forestry required the transfer of a sufficient number of NZUs for surrender as part of the negotiations, but was not prepared to pay anything for these NZUs.

Fiona's Forestry Ltd and Timmy's Trees Ltd agreed to a purchase price allocation of the $120 purchase price as follows:

- class (ii) timber 100
- class (vi) capital account land 20

Timmy's Trees Ltd will have income tax obligations of $100 for this sale (attributable to the timber). Fiona's Forestry Ltd will be able to deduct the same purchase price allocated to the timber at the time of disposal. Fiona's Forestry Ltd will not be able to deduct anything at the time of surrender of NZUs.

Timmy's Trees Ltd and Fiona's Forestry Ltd should keep records of their negotiations and the valuations to support their agreed allocation.

136. Also, if there is no clear surrender obligation (for example for a permanent forest or a forest using averaging accounting) the market value of NZUs should always be taken into account. Similarly, for a forest using stock change accounting, NZUs should be allocated value unless there is a clear surrender obligation and the amounts are reflected in the negotiated purchase price, accounting treatment and in a valuation.

Example | Tauira 7 – NZUs with no clear surrender obligation

Fiona's Forestry Ltd and Timmy's Trees Ltd entered a third sale and purchase agreement where Fiona's Forestry Ltd acquired a standard forest that uses averaging accounting for $150.

Fiona's Forestry Ltd planned to replant the forest after harvest for at least three rotations so would not have surrender liabilities.

Due to there being no surrender obligation under averaging accounting, Fiona's Forestry Ltd is prepared to pay a higher purchase price and utilise the NZUs in repurchase arrangements.

Fiona's Forestry Ltd and Timmy's Trees Ltd agreed to a purchase price allocation as follows:

- class (i) trading stock (NZUs) 30
- class (ii) timber 100
- class (vi) capital account land 20

Timmy's Trees Ltd will have income tax liabilities of $130 on the sale of timber and NZUs. Fiona's Forestry Ltd will be able to deduct the purchase price allocated to the timber ($100) and the NZUs ($30) at the time of disposal.

137. It can be seen from the above that there is no particular method that must be applied for allocating the purchase price among the assets in a sale of a forest. It is fact and valuation dependent.

138. The Commissioner generally accepts purchase price allocations that follow generally accepted industry treatment or valuation methodologies. However, it is acknowledged that in the forestry context there may not be generally accepted treatment. The important point is that both parties are consistently allocating the same amount to the same assets and that appropriate values are allocated between (for example) capital and revenue amounts.

Repurchase arrangements involving NZUs and offtake arrangements

139. NZUs may be used in a variety of different arrangements and parties may structure these arrangements in different ways. This part of the statement provides general information on repurchase and offtake arrangements.

140. Due to the differing fact situations that exist, the Commissioner cannot provide general advice on these arrangements. Foresters who would like certainty on their tax treatment should seek advice and may wish to consider applying for a private ruling or a short process ruling to confirm their tax treatment. For information on applying for a ruling, see: short-process-rulings.

Repurchase arrangements

141. Some common transactions are NZU repurchase arrangements, which can occur through:

- a transfer of NZUs as a loan with the payment of a fee and repayment of NZUs in the future (a lending transaction), or
- a sale with a specified buy-back in the future (a repurchase transaction).

142. In either situation, the initial transfer (whether this occurs as a sale or a loan) is treated as a disposal of the NZUs for tax purposes.

143. Section CB 36 provides that amounts derived from the disposal of emissions units are income. The ordinary meaning of "disposal" means to get rid of something. The High Court of Australia in McGain v FCT (1966) 14 ATD 190 held that a loan of cash involves the disposal of property. The court said that gifts, loans and sales all involve a disposition. This decision was approved by the New Zealand Court of Appeal in Rossiter v CIR (1976) 2 NZTC 61,197.

144. In the context of share lending, in an Australian case (Lift Capital Partners Pty Ltd v Merrill Lynch International (2009) 253 ALR 482 (NSWSC)) it was similarly said:

> [84] The concept here is that one person "disposes" of securities to another person and later either "re-acquires" those securities from that other person or "acquires" identical securities from that other person. In either case, there is an initial transfer of ownership by the "lender" to the "borrower" and a subsequent transfer of ownership (of either the same or identical securities) by the "borrower" to the "lender". ...

145. Therefore, with either a lending or repurchase transaction involving NZUs, there is a disposal and then a subsequent reacquisition of NZUs. The share lending rules in the ITA 2007 do not apply to treat the sale and repurchase as a loan, because NZUs are not shares.

Pre-1990 forest land NZUs

146. Specific rules apply to transactions involving pre-1990 forest land NZUs but these rules are restricted to only those types of NZUs.

147. Section EW 5(11C) provides that an arrangement is an excepted financial arrangement that is subject to s EW 52B where it involves the use of pre-1990 NZUs as security for a lending arrangement. That is, as part of a financial arrangement that is a loan to the holder by the other person, there is:
    - the assignment of a pre-1990 forest land NZU by the holder to a non-associated person, and;
    - the later assignment of an NZU back to the original holder by that other person.

148. Section EW 52B provides that the holder is treated as continuing to hold a pre-1990 forest land NZU during the arrangement. The returned NZU is treated as being the original pre-1990 forest land NZU and its cost is treated as the cost of the original NZU. This provision overrides subpart ED in respect of allocating values to the NZUs. However, the rules require a timely return of the NZU to the holder and a failure to do so will result in these rules not applying.

149. The effect of these provisions is that where a person lends pre-1990 forest land NZUs as security, no income tax consequences arise from any disposals and reacquisitions of those NZUs. The original holder is treated as remaining the holder of a pre-1990 forest land NZU as defined in s YA 1 (and it does not lose that status when NZUs are returned to the holder).

150. Any fees payable to the holder for the transaction are taxable income under ordinary principles (s CA 1(2)).

Other types of NZUs

151. There are no rules similar to s EW 52B that apply to other types of NZUs. Any amounts received for the disposal are taxable under s CB 36. If no amounts are received for the disposal, s GC 1 may apply to deem a market value amount to be derived, unless the exception applies where the transaction occurs in the course of carrying on a business and the parties are not associated.

152. Any fees payable to the person lending the NZUs are income to the lender under s CA 1(2) when derived. These amounts are not "interest" for tax purposes because they are not paid for money lent. Fees may be separately identified or embedded into the price paid under the arrangement. The disposal of the NZUs also crystallises any deduction available to the lender (although if the NZUs lent were forest land NZUs then the available deduction is zero).

153. Importantly, the disposal of NZUs under such an arrangement will mean that, on receiving equivalent NZUs back in the future, they will not be classed as "post-1989 forest land emissions units". The NZUs lose their status, which may have tax consequences.

154. The other party to the transaction (the borrower) will be entitled to an upfront deduction for the cost of acquiring the NZUs under the arrangement to the extent that an amount is paid for the NZUs and to the extent that the NZUs are a replacement forest land NZU for that person (that is, they are acquired for surrender for an emissions liability as a replacement for a forest land NZU.

155. In summary, foresters who enter NZU repurchase arrangements need to carefully consider the consequences of such arrangements. The consequences depend on the particular contractual terms the parties have entered into. Most relevantly, the NZUs will lose their status as post-1989 forest land NZUs which may have tax consequences.

156. Any amounts paid under the arrangement to acquire NZUs are taxable to the recipient and deductible to the payer (the timing of deductions depend on the type of emissions units being purchased).

157. For completeness, because NZUs are excepted financial arrangements under s EW 5(3B), the financial arrangements rules do not apply to any gains or losses resulting from the change in value of the NZUs over the period of an NZU repurchase arrangement that are solely attributable to the NZUs. This would also turn on the terms of the contractual arrangements.

158. The following example illustrates the above concepts. How the tax rules apply to any particular arrangement depends on the particular facts and contractual terms the parties enter into, for example fees may be embedded into pricing rather than being separately identified. Due to the differing fact situations that may exist, the Commissioner cannot provide general advice on how the tax laws apply to these arrangements.

Example | Tauira 8 – Sale and repurchase of NZUs

Ray's Radiatas Ltd from Example | Tauira 3 needed NZUs for surrender in May 2024. Ray's Radiatas Ltd expected to earn NZUs in the future from a younger forestry block.

Fiona's Forestry Ltd had excess NZUs available and agreed to provide these to Ray's Radiatas Ltd under a sale and repurchase agreement.

In April 2024, Fiona's Forestry Ltd agreed to provide Ray's Radiatas Ltd 500 NZUs in return for Ray's Radiatas Ltd providing 500 NZUs in 3 years' time. Ray's Radiatas Ltd paid a separate fee for the use of the NZUs.

Any gain or loss attributable to the value of the NZUs is solely attributable to the NZUs and is not taken into account under the financial arrangements rules. The fee is taxable income. Depending on how the arrangement is structured the fee may be income from a financial arrangement, or may be subject to ordinary principles.

The lending arrangement was a deal between non-associated parties made in the course of carrying on their respective businesses. Therefore, s GC 1 does not apply.

NZU off-take arrangements

159. Foresters may also undertake NZU off-take arrangements. An off-take arrangement involves a person who requires NZUs for surrender agreeing with a forester to acquire a certain amount of NZUs at a particular time for a payment. These agreements could be structured in different ways, for instance this could involve a forester agreeing to provide NZUs as they are earned, or a certain amount per year, or in lump sums at certain times.

160. The tax treatment of these arrangements depends on the particular facts. The financial arrangements rules may apply (although any changes in value of the NZUs is solely attributable to an excepted financial arrangement). There may be issues with the timing of derivation of income, depending on the relationship between when payments are made and when NZUs are provided.

161. This statement cannot provide general guidance on these arrangements because the tax consequences depend on how the deals are structured. Foresters undertaking these arrangements should seek advice about the tax consequences.

GST consequences

162. GST obligations for supplies of NZUs made by a GST registered person are reasonably settled. NZUs are services and not goods for GST purposes. Supplies of NZUs are subject to GST. However, most supplies of NZUs are zero-rated for GST purposes under s 11A(1)(s) – (w) of the Goods and Services Tax Act (GSTA).

163. Section 11A of the GSTA zero rates:

- the transfer of NZUs (other than certain transfers by the Crown that are not relevant in the forestry context);
- the surrender of NZUs under s 63 of the CCRA (ie, for emissions);
- the supply of services to or by the Crown in consideration for which there is no payment of a price and that is zero rated above; and
- a disposal of similar types of units that are issued by reference to the sequestration or avoidance of emission, of human-induced greenhouse gases and verified to an internationally recognised standard.

164. Therefore, the transfer or surrender of NZUs is zero rated for GST purposes. This means the relevant supplies are subject to GST but at a rate of 0%.

165. If a registered person deregisters from GST while still holding NZUs, the person is treated as making a zero-rated supply of those NZUs at the time of deregistration under s 5(3C). This means there are no GST consequences where a person continues to hold NZUs while they are deregistering from GST.

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Income Tax Act 2007, ss CA 1(2), CB 36, CH 1, CX 51(B), CX 54B, DA 1, DB 49, DB 60, DB 60B, GC 1, GC 3B, GC 20, GC 21, ED 1, ED 1(7B), EW 5(3B), EW 5(11C), EW 52B, and s YA 1 (definitions of "forest land emissions unit" "forest sink emissions unit", "post-1989 forest land emissions unit"; "pre-1990 forest land emissions unit" "replacement forest land emissions units", "revenue account property", "trading stock").

Case references | Tohutoro kēhi

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QUESTIONS WE'VE BEEN ASKED

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

QB 25/01: Income tax – Which rules apply if I rent out my home, part of my home, or a separate dwelling on my property as short-stay accommodation?

Issued | Tukuna: 3 April 2025

This question we've been asked (QWBA) explains how the income tax rules apply if you occasionally rent out your home, a room in your home, or a separate dwelling on your property for short stays (for example, through Airbnb, Bookabach, Booking.com or Holiday Houses).

Key provisions | Whakaratonga tāpua

Income Tax Act 2007 – ss CH 5B, DB 2, EL 9 and GC 5

REPLACES | WHAKAKAPIA:

- **QB 19/05**: What are my income tax obligations if I rent out my home or a separate dwelling on my property as short-stay accommodation?

Question | Pātai

Which rules apply if I rent out my home, part of my home, or a separate dwelling on my property as short-stay accommodation?

Answer | Whakautu

Renting out your home or part of your home

If you rent out your home or part of your home as short-stay accommodation, any amounts you receive from guests will be rental income.

However, you have different options for meeting your income tax obligations, depending on your circumstances:

- You may be able to use standard costs set by the Commissioner for your expenses. If you use this approach, your rental income up to the level of the standard costs will be exempt income. You only have to declare the rental income in excess of the standard costs.
- If you cannot use the standard cost approach, or you do not want to, your deductions will be based on your actual expenses related to earning the rental income. This is known as the actual cost approach. Some of those expenses will only be partly deductible because they also relate to your private use of the home.

If you use the actual cost approach and you are:

- not GST-registered:
  - and have opted to treat the flat-rate credit as excluded income, expenses that relate to rental income from an online marketplace are deductible on a GST-exclusive basis and expenses that relate to rental income from other sources are deductible on a GST-inclusive basis. and have opted to treat the flat-rate credit as assessable income, all your expenses that relate to rental income (from an online marketplace or otherwise) are deductible on a GST-inclusive basis.
- GST-registered, expenses are deductible on a GST-exclusive basis.

Renting out a separate dwelling on the same property as your home

If you rent out a separate dwelling on the same property as your home for short-stay accommodation, different income tax rules could apply, depending on your situation.

Key terms | Kīanga tau tāpua

Guest means a person provided with short-stay accommodation in return for payment.

Online marketplace means an electronic platform like a website, app or internet portal that sellers use to market and sell their short-stay accommodation. It does not include an online marketplace that only processes payments.

Short-stay accommodation means accommodation provided for up to four consecutive weeks in a dwelling that is not the guest's ordinary residence. It does not include accommodation provided to residential tenants, boarders or care home residents, and it does not include student or emergency accommodation.

Explanation | Whakamāramatanga

1. Different income tax rules apply depending on whether you are renting out your own home or part of your home, or a separate dwelling on the same property.

Renting out a separate dwelling on the same property as your home

2. If you rent out a separate dwelling on the same property as your home (for example, a sleep-out or cottage on the property) for short-stay accommodation, different income tax rules could apply, depending on your situation.
3. The dwelling is considered a separate asset. If the dwelling is only rented out and never used privately, all the rental income will be taxable, and you can fully deduct your non-capital expenses in relation to the dwelling (subject to needing to claim these deductions on a GST-exclusive basis).[1]
4. If, in addition to sometimes renting out the dwelling, you also sometimes use it privately, the dwelling will either fall under the mixed-use asset rules or the standard tax rules. To work out which rules apply, see **QB 25/02: Income Tax – Which rules apply if I have a dwelling I sometimes rent out as short-stay accommodation and also sometimes use privately?** However, if the dwelling is separate from your home, but there are shared common areas (for example, the dwelling is a sleep-out and guests share a bathroom located in your home), expenses relating to that part of your home are partially deductible. Example | Tauira 3 illustrates this.

Renting out your home or part of your home

5. If you rent out your home or part of your home as short-stay accommodation, any amounts you receive from guests will be taxable as rental income. The activity does not need to be run as a business for the amounts you receive to be rental income.
6. Depending on your circumstances, you may have two options for meeting your tax obligations (summarised in Table | Tūtohi 1:
   - the standard-cost approach; or
   - the actual-cost approach.
7. If you meet certain criteria, you can calculate your deductions using a formula set by the Commissioner, which is based on a set deductible amount for each rental night. This is referred to as the standard-cost approach. If you use this approach, you do not declare income from the rental activity, up to the amount you calculate under the formula (your standard costs). You only need to declare rental income you make to the extent it exceeds your standard costs. This approach is easier, because you do not have to work out your actual deductible expenses, which would require some of the expenses being apportioned. The criteria you must meet to use this approach are set out at [9].

1 For a list of deductible and non-deductible rental property expenses, go to www.ird.govt.nz and search "rental property expenses".

8. If you cannot use the standard-cost approach, or you do not want to, your deductions will be based on your actual costs related to earning the rental income. This is referred to as the actual-cost approach. Expenses that relate solely to your rental activity (for example, advertising fees) are fully deductible (subject to these deductions needing to be claimed on a GST-exclusive basis).[2] However, mixed expenses, that relate to both your rental activity and your own use of your home (for example, home loan interest, home insurance and rates), must be apportioned. This QWBA will help you understand how to calculate the percentage of your mixed expenses that's tax deductible.

Table | Tūtohi 1 – Comparison of standard-cost and actual-cost approaches

Standard-cost approach	Actual-cost approach
Rental income up to the amount of your standard costs is exempt income. You do not include this income in your tax return. The amount of rental income in excess of your standard costs is assessable income. You need to include that amount in your tax return. You cannot claim deductions for any of your actual expenses that are covered by the standard-cost approach in **DET 19/02: Standard-cost household service for short-stay accommodation providers**.	All the rental income is assessable income and must be declared. You can claim associated expenses and depreciation losses as deductions. You need to work out how much you can deduct, bearing in mind that: • The starting point is that expenses that relate solely to the rental activity (for example, advertising) are fully deductible. • Mixed expenses (for example, home loan interest, home insurance and rates), must be apportioned. • Depreciation losses for chattels used both privately and by paying guests must be apportioned. • Your deductions may need to be claimed on a GST-exclusive basis.[3]
If you are not the only owner of the property, you will need to think about who should declare the rental income – see from [58].	

Can I use the standard-cost determination for short-stay accommodation providers?

9. You can use the standard-cost approach in **DET 19/02: Standard-cost household service for short-stay accommodation providers**, if:
   - you are a natural person (an individual not a company);
   - you rent out a room or rooms in your home to guests for short-stay accommodation (no more than four consecutive weeks);
   - you do not rent out rooms in your home for more than 100 nights in the income year (counting each room that is rented out separately);
   - the property is not held in a trust, or if it is you paid all the costs for the income year for the use of the property (for example, home loan interest or rent, home insurance, rates, and repairs and maintenance);
   - you do not provide the short-stay accommodation service as part of a GST taxable activity;
   - your home is not used in the income year to provide both a short-stay accommodation service and a private boarding service (as defined in **DET 19/01: Standard-cost household service for boarding service providers** or any determination that replaces DET 19/01);
   - neither you nor anyone else applies any other standard-cost household service determination in relation to services provided in the home (for example, **DET 09/02: Standard-cost household service for childcare providers**); and
   - no one claims deductions for actual costs incurred in relation to the use of your home to provide accommodation to others, such as flatmates, for any time in the income year when the short-stay accommodation service is provided.

2 See from [34].

3 See from [34].

10. If you meet all these criteria and choose to use the standard-cost approach for the income year, the rest of this QWBA will not be relevant to you. If you choose to use the standard-cost approach, DET 19/02 explains what you need to do to meet your income tax obligations.
11. You can only use the standard-cost approach for income years in which you meet the criteria. If you do not meet the criteria for a particular income year, you will need to base your deductions for that year on your actual costs, which will involve apportioning some expenses. This QWBA explains how the rules work if you have to, or choose to, use the actual-cost approach.

Can I use the standard-cost determination for boarders instead?

12. A separate determination sets standard costs for expenses for people who receive income from private boarders. You cannot use that determination for income from providing short-stay accommodation. This is because short-stay accommodation guests are not boarders. A boarder is someone who lives in your home and receives meals, in return for payment. To be a boarder, the person must actually live in your home and use it as their normal residence for a period (often this is a year or a semester). Someone who pays to stay in your home for a short period and is not using it as their normal residence is not a boarder. This QWBA calls these people "guests".
13. If you receive income from both boarders and short-stay accommodation guests, you cannot use either of the standard-cost determinations. You need to use your actual costs for your deductions.

If I am using the actual-cost approach, what portion of my expenses can I claim deductions for?

14. As noted in Table | Tūtohi 1, if you are using the actual-cost approach the starting point is that some of your expenses are fully deductible and some are only partly deductible. This is because some of your expenses (for example, home loan interest, home insurance and rates) relate partly to your rental activity and partly to your own private use of your home.
15. You can also claim deductions for the depreciation of the chattels in your home that paying guests can use. But, as with your mixed expenses, you can only claim for part of the depreciation for chattels that are used both privately and by paying guests.
16. While the starting point is that the above expenses may be fully deductible, if you rent the dwelling through an online marketplace, your deduction may need to be claimed on a GST-exclusive basis. This is discussed from [34].
17. The following will help you work out what deductions you may claim – and will help you calculate what percentage of your mixed expenses and depreciation is tax deductible.

Expenses that may be fully deductible – relate solely to rental activity

18. You may be allowed to fully deduct expenses that relate solely to your rental activity. These expenses might include:
    - advertising costs, including any commissions or fees you pay to an advertising platform or transaction facilitator (this does not include any service fees the guests pay the platform – just fees you pay);
    - supplies used solely by your paying guests (for example, if you provide them with a welcome basket of breakfast food or chocolates);
    - any additional home or contents insurance premium you pay (over what you would otherwise pay) because the property is used for short-stay accommodation; and
    - any additional rates you pay (over what the normal residential rates would be) because the property is used for short-stay accommodation.[4]
19. You may have some expenses that you can split between being related solely to your rental activity and being mixed rental and private expenses. For example, expenses that have a fixed component and a usage component, like power. If you can identify actual usage charges for a period where your home was only rented out and not used privately at all, you do not have to apportion the usage component for that period – it is fully deductible. The fixed charge component still needs to be apportioned, as it is necessary to maintain a power connection, which is used both privately and by paying guests.
20. While the starting point is that the above expenses may be fully deductible, if you rent the dwelling through an online marketplace, your deduction may need to be claimed on a GST-exclusive basis. This is discussed from [34].

4 Some councils may impose targeted rates in respect of properties used for short-stay accommodation.

Expenses that are non-deductible – relate solely to private use

21. Expenses that relate solely to the private use of your home are not deductible. Similarly, any consumables you use in your home are not deductible. However, if you have consumables you use in your home that are also available for guests to use (for example, tea, coffee, olive oil, shampoo, and soap), those consumables are partly deductible.
22. If you vacate your home while it is being rented out as short-stay accommodation and you need to pay for alternative accommodation for yourself (such as a hotel), the cost of that alternative accommodation is not deductible as it is private expenditure.

Expenses that are partly deductible – relate to both rental activity and private use

23. Expenses that relate to both your rental activity and the private use of your home are not fully deductible. You may be able to claim a deduction for part of the expenses. These mixed expenses might include:
    - interest on your home loan;[5]
    - repairs and maintenance;[6]
    - home and content insurance premiums (excluding any additional premium imposed because your home is used for short-stay accommodation – as noted at [18], those amounts will be fully deductible);
    - rates (excluding any targeted rates imposed by councils because your home is used for short-stay accommodation – as noted at [18], those amounts will be fully deductible);
    - power bills (but see [19]); and
    - internet.
24. In most situations where you rent out all or part of your home you need to work out what proportion of these mixed expenses you can claim. You need to take into account:
    - the floor area of different parts of your house; and
    - the number of nights during the income year that the room was rented out.
25. If there is a reasonable basis for apportioning a particular expense other than on floor area, you can use that.
26. In exceptional cases, instead of using the number of nights the room was actually rented out to apportion mixed expenses, you can use the periods it was either rented out or **available** to be rented out. This is explained below from [29].

How to apportion mixed expenses based on the number of rental nights and floor area

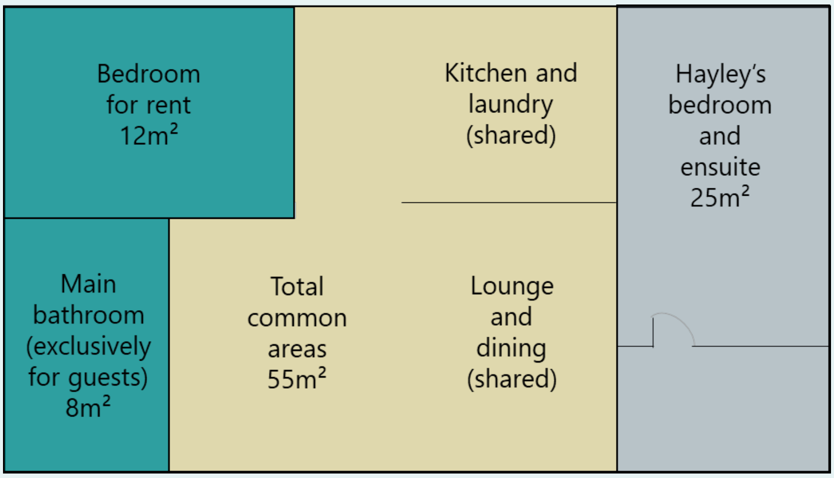
27. Generally, you should apportion mixed expenses, like those at [23], based on the floor area that the guest has exclusive use of, as a proportion of the total floor area of your house. You may also add a reasonable amount based on the guest's access to common areas – Inland Revenue will accept 50% as a reasonable amount in most situations. Generally, where you rent a room in your house you may only claim expenses for nights the room was rented out.

5 If the home you are renting out is your main home, the interest limitation rules do not apply (s EL 9). However, the actual amount claimed needs to be apportioned for any private use. See **IS 23/04: The interest limitation rules and short-stay accommodation.** If the home you are renting out is not your main home, from 1 April 2024, up to 80% of the interest on your home loan can be claimed, and from 1 April 2025 up to 100% of the interest can be claimed. The actual amount claimed needs to be apportioned for any private use.

6 Deductible repairs and maintenance expenditure does not include expenditure on capital improvements (see **IS 12/03: Income tax – Deductibility of repairs and maintenance expenditure – general principles**).

Example | Tauira 1 – Apportioning mixed expenses based on the number of rental nights and floor area

Hayley has a two-bedroom villa. She uses the second bedroom occasionally as an office, or as a bedroom when friends or family stay. She decides to rent out the second bedroom through an online marketplace to make some extra money. When she rents out the room, the guests are also able to use some common areas in the villa – the lounge, dining room, kitchen, laundry, and main bathroom. Hayley rents out the room for 120 nights during the income year. She is unable to use the standard-cost determination discussed at [9] because she rents out the room for more than 100 nights in the income year. The floor areas of the different parts of Hayley's villa are shown in the diagram below.



Hayley should apportion her mixed expenses on the following basis:

20m²	Used exclusively by guests – 100% deductible for days the room is rented out
55m²	Common areas – 50% deductible for days someone is renting the bedroom
25m²	Private area – 0% deductible

Hayley must calculate what proportion of her mixed expenses she can deduct for the areas of the house used exclusively by guests, and what proportion she can deduct for the common areas. The results of those calculations are then added together.

The areas used **exclusively by guests** are 20m² out of the total 100m² floor area of the villa, and are 100% deductible for the 120 out of 365 days in the year that the room is rented out:

$$\frac{20}{100} \times \frac{120}{365} \times 100 = 6.58\%$$

The **common areas**, able to be used by both Hayley and guests, are 55m² out of the total 100m² floor area of the villa, and are 50% deductible for the 120 out of 365 days in the year that the room is rented out:

$$\frac{55}{100} \times \frac{120}{365} \times 50 = 9.04\%$$

Adding these figures (6.58% and 9.04%) together, Hayley calculates she can deduct 15.62% of her mixed expenses for the income year. Her mixed expenses include her power and internet bills, the interest on her home loan, her home and contents insurance premiums, and her rates.

In addition, Hayley can fully deduct her expenses that relate solely to the rental activity (other than the GST component). These expenses include the cost of advertising the room for rent, her host service fees, the sheets and towels she bought for guests to use (she only uses those for guests renting out the room), and the tea, coffee, sugar, cereal and milk the guests use.

As Hayley is not GST-registered and has opted to treat the flat-rate credit as excluded income, and as her rental income relates to nights when part of her home was rented through an online marketplace, her expenses are deducted on a GST-exclusive basis. This is discussed in more detail from [34] and in Example | Tauira 5.

28. If you rent out your whole house for a period, and the guests have access to the whole house, you do not need to use the floor area calculations. Your apportionment for that period would be based only on the number of nights the house is rented out.

Example | Tauira 2 – Apportioning mixed expenses based on the number of rental nights

Jason and Kim are saving for an overseas holiday and decide to rent out their apartment for four weeks during a high-profile sporting event in their city. They found their guests through a friend who had family wanting to come to town for the event. Jason and Kim stay with Jason's parents during this time.

Jason and Kim should apportion their mixed expenses on the following basis:

The whole apartment is used **exclusively by guests** for 28 out of the 365 days in the income year, and the mixed expenses are 100% deductible for that period:

$$\frac{28}{365} \times 100 = 7.67\%$$

Therefore, Jason and Kim can deduct 7.67% of their mixed expenses for the income year. Their mixed expenses include 28 days' worth of the daily fixed charge for their power connection, internet, the interest on their home loan, their home and contents insurance premiums, and their rates.

In addition, Jason and Kim may deduct 100% of their expenses that relate solely to the rental activity. These expenses include the cost of advertising the apartment for rent, the power usage charges for the period (if this cannot be identified precisely an average may be used), and supplies used by the guest (for example, cleaning products, toilet paper, and pantry staples).

As Jason and Kim are not GST-registered, and the short-stay accommodation was not rented through an online marketplace, their expenses are deducted on a GST-inclusive basis. This is discussed in more detail from [34].

How to apportion mixed expenses based on availability

29. As noted in [26], in exceptional cases, instead of using the number of nights the space was actually rented out as a basis for apportioning mixed expenses, you can use the periods it is either rented out or **available** to be rented out.

30. For a room in your home, you could only do this where you do not use the room at all, including for storage, and it is essentially not used as part of your home. This would be difficult to show, as in most situations it would be expected that expenses for a room in your own home are private expenses for periods when the room is not actually rented out. One example where you might be able to show otherwise is if you operate a bed and breakfast with high occupancy, in your home, so the rental rooms are essentially not used as part of your home. Example | Tauira 4 covers a situation like this.

31. Another situation where availability could potentially be used is if you have a separate dwelling on the same property as your home that is not used as part of your home and is not a mixed-use asset. For example, a sleep-out that is only rented out and not used privately at all, or a sleep-out that is rented out and used privately but is not unused for 62 days or more in the year. In those situations, the mixed-use asset rules would not apply – see **QB 25/02**. Example | Tauira 3 covers a situation like this.

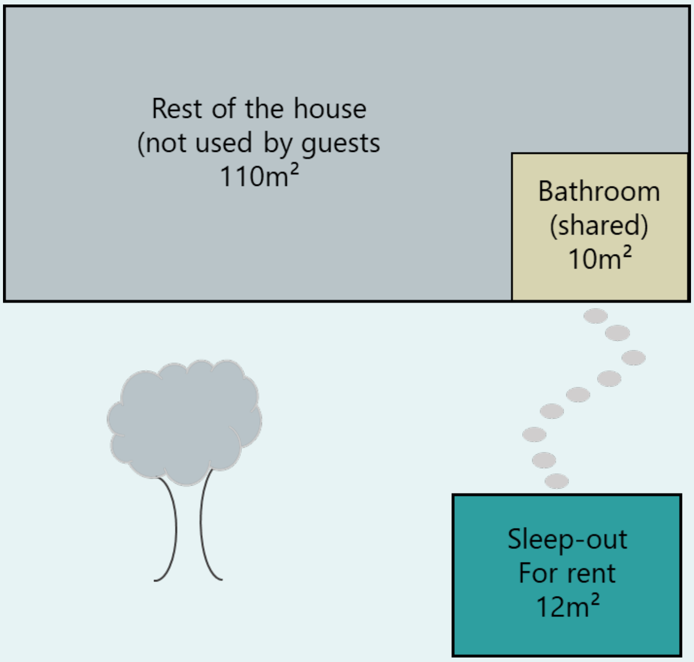
32. In situations where you can use the periods the space is either rented out or **available** to be rented out and not used privately, you need to have evidence that shows when the space was available to be rented out. Evidence that the space is available for rent would need to be more than a mere statement of its availability, sporadic or limited advertising, or advertising that is not likely to attract many customers. You need to have evidence of active and regular marketing of the space at market rates, and evidence that it is available at times and for periods that demonstrate it is genuinely available to rent.

Example | Tauira 3 – Apportioning mixed expenses based on availability – a separate dwelling from your home

Melanie and Alistair live in a popular wine region, and regularly rent out the sleep-out in their garden. The sleep-out is advertised year-round, and in the last income year it was available for rent at all times other than for six weeks (42 nights) when Melanie's parents came to stay and used the sleep-out.

In the income year, the sleep-out was used to earn income and was also used privately by Melanie's parents. Melanie and Alistair used QB 25/02 to work out the sleep-out is not a mixed-use asset for the income year because it was only unused for 58 days (although it was available for use at those times). The sleep-out needs to have been unused for 62 days or more to be a mixed-use asset. Therefore, the rules in this QWBA apply.

The sleep-out does not have a bathroom, so guests who stay there use the main bathroom in Melanie and Alistair's house, which can be accessed from the garden. The sleep-out is on a separate power connection from the house. Guests can use Melanie and Alistair's wi-fi. There are tea and coffee facilities in the sleep-out, and guests can order a cooked breakfast for an additional charge. Melanie and Alistair rented out the sleep-out for 265 nights during the income year. The floor areas of the different parts of the property are shown in the diagram below.



Melanie and Alistair should apportion their mixed expenses on the following basis:

12m²	Used exclusively by guests – 100% deductible for days the sleep-out is rented out or available to be rented out, as it is not used by Melanie and Alistair
10m²	Common areas – 50% deductible for days someone is renting the sleep-out
110m²	Private area – 0% deductible

Melanie and Alistair have to calculate what proportion of their mixed expenses they can deduct for the sleep-out, which was used exclusively by guests, and rented or available for rent for all but six weeks (42 nights) of the year, and what proportion they can deduct for the common area (the shared bathroom). The results of those calculations are then added together.

The sleep-out, used **exclusively by guests**, is $12m^2$ out of the total $132m^2$ floor area of the dwellings on the property, and is 100% deductible for the 323 out of 365 nights in the income year that it was either rented out or available to be rented out:

$$\frac{12}{132} \times \frac{323}{365} \times 100 = 8.04\%$$

The **common area**, the shared bathroom, which is able to be used by Melanie and Alistair and guests, is $10m^2$ out of the total $132m^2$ floor area of the dwellings on the property, and is 50% deductible for the 265 out of 365 nights in the income year that the sleep-out is rented out:

$$\frac{10}{132} \times \frac{265}{365} \times 50 = 2.75\%$$

Adding these figures (8.04% and 2.75%) together, Melanie and Alistair calculate that they can deduct 10.79% of their mixed expenses for the income year. Their mixed expenses include their internet expenses, the interest on their home loan, their property and contents insurance premiums, and their rates.

Because the sleep-out is on a separate power connection from the house, Melanie and Alistair may deduct 100% of the power bills for the sleep-out for the 323 out of 365 nights in the year that it is either rented out or available to be rented out.

In addition, Melanie and Alistair can fully deduct their expenses that relate solely to the rental activity. These expenses include the cost of advertising the sleep-out for rent, the host service fees, and the tea and coffee supplies in the sleep-out.

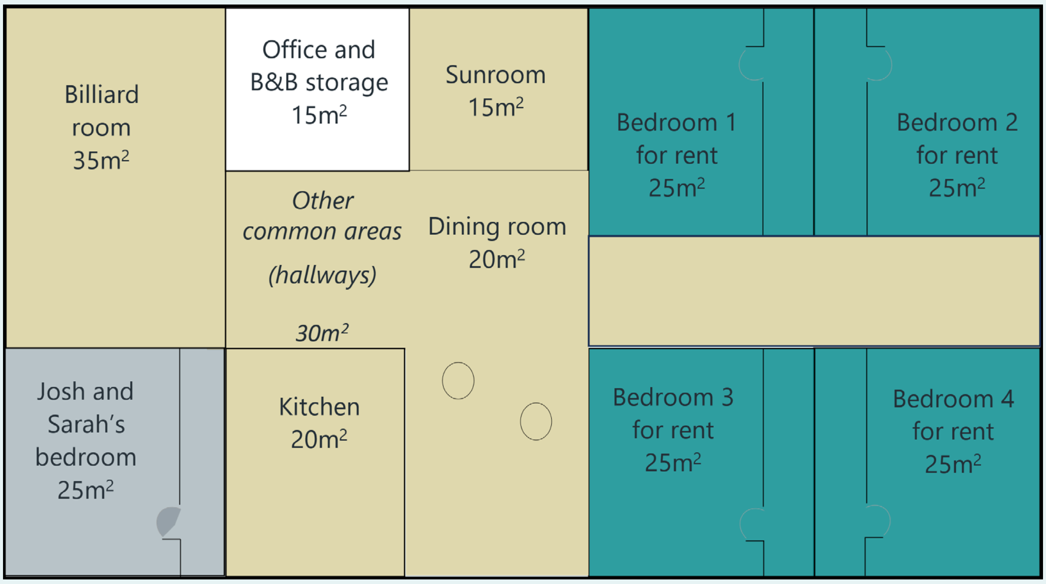
The amounts Melanie and Alistair receive for cooked breakfasts are income, and they can deduct the cost of the ingredients used.

All expenses are deducted on a GST-exclusive basis because Melanie and Alistair are GST-registered. This is discussed in more detail from [34].

33. As noted in [24], where you occasionally rent out a room in your home, normally you need to apportion your mixed expenses based on the number of nights the room is actually rented out (as shown in Example | Tauira 1). This is because when you are not renting out the room, those expenses are purely private expenses related to keeping your home. However, the following example shows a situation where the Commissioner would accept that the mixed expenses could be apportioned based on the **availability** of the rooms for rent.

Example | Tauira 4 – Apportioning mixed expenses based on availability – space within your home

Josh and Sarah run a bed and breakfast (B&B) from their home in a tourism hotspot. The B&B has four bedrooms, each with an ensuite, which are advertised year-round and are available for rent at any time other than for three weeks in winter, when Josh and Sarah take a holiday. Guests can use a sunroom and a billiard room. If guests wish to dine in, meals can be enjoyed in the dining room, or room service can be requested. The B&B has approximately 60% occupancy, and Josh and Sarah had guests in at least one room for 300 days during the income year. The floor areas of the different parts of the B&B are shown in the diagram below.



Josh and Sarah should apportion their mixed expenses on the following basis:

15m²	Used exclusively for the B&B operations – 100% deductible
100m²	Used exclusively by guests – 100% deductible for days the rooms are rented out or available to be rented out, as they are not used by Josh and Sarah
120m²	Common areas – 50% deductible for days someone is renting a room in the B&B
25m²	Private area – 0% deductible

Josh and Sarah must calculate what proportion of their mixed expenses they may deduct for the:

- office and storage area, which is used exclusively for B&B operations;
- rental rooms, which are used exclusively by guests and are available for rent for 49 weeks of the year; and
- common areas.

They then need to add the results of those calculations together.

The office and storage area, used **exclusively for B&B operations**, is 15m² out of the 260m² total floor area of the house, and is 100% deductible as it is only used in relation to the rental activity:

$$\frac{15}{260} \times 100 = 5.77\%$$

The rental rooms, used **exclusively by guests**, are 100m^2 out of the total 260m^2 floor area of the house, and are 100% deductible for the 49 out of 52 weeks in the year that the rooms are either rented out or available to be rented out:

$$\frac{100}{260} \times \frac{49}{52} \times 100 = 36.24\%$$

The **common areas**, which are used by Josh and Sarah and guests, are 120m^2 out of the total 260m^2 floor area of the house, and are 50% deductible for the 300 out of 365 days in the year that at least one of the rooms is rented out:

$$\frac{120}{260} \times \frac{300}{365} \times 50 = 18.97\%$$

Adding these figures (5.77%, 36.24% and 18.97%) together, Josh and Sarah calculate that they can deduct 60.98% of their mixed expenses for the income year. Their mixed expenses include their power bills, internet expenses, the interest on their home loan, the amount of their property insurance premium that equates to what their premium would be if they did not run the B&B from the property, and the portion of their rates that they would have to pay if they did not run the B&B from the property (what normal residential rates would be for the property).

In addition, Josh and Sarah can fully deduct their expenses that relate solely to the rental activity. These expenses include:

- the cost of advertising the rooms for rent;
- the host service fees;
- the amount they pay in additional property insurance premiums (over what they'd pay if they did not run the B&B from the property);
- the amount they pay in additional rates (over what the normal residential rates would be) because they run the B&B from the property; and
- bathroom supplies for the rooms.

The amounts Josh and Sarah receive for meals purchased by guests are income, and they can deduct the costs of providing those meals.

All expenses are deducted on a GST-exclusive basis because Josh and Sarah are GST-registered. This is discussed in more detail from [34].

Online marketplace rules

If you are not GST-registered

34. If you are not GST-registered and rent out your home, part of your home, or a separate dwelling on your property as short-stay accommodation through an online marketplace like Airbnb, Bookabach, Booking.com or Holiday Houses, the marketplace operator will give you a flat-rate credit of 8.5% of the value of the supply of short-stay accommodation.
35. You have the option to treat the flat-rate credit as either:
    - excluded income (which is not subject to income tax, so is not included in your income tax return); or
    - assessable income (which is included in your income tax return).

    (Section CH 5B).
36. If you opt to treat the flat-rate credit as assessable income, all your expenses are deducted on a **GST-inclusive basis** (s DB 2).
37. However, if you opt to treat the flat-rate credit as excluded income:
    - Expenses that relate to nights when the dwelling was rented through an online marketplace are deducted on a **GST-exclusive** basis. This is because the flat-rate credit you receive from the online marketplace is intended to recognise the GST on the expenses you incur when deriving this income, that you would be able to deduct as input tax in your GST return if you were GST-registered.
    - Expenses that relate to nights when the dwelling was rented out other than through an online marketplace, or was available to be rented out, are deducted on a **GST-inclusive** basis.

    (Section DB 2).

38. If you have opted to treat the flat-rate credit as excluded income, and you have expenses that relate to both nights when the dwelling was rented through an online marketplace and nights when the dwelling was rented out other than through an online marketplace or was available to be rented out, these expenses must be apportioned.
39. Depreciation continues to be calculated on the GST-inclusive price of the asset. This is the position, even if you rent your home through an online marketplace.

Example | Tauira 5 – Apportioning expenses where a person is not GST-registered, has opted to treat the flat-rate credit as excluded income, and their dwelling is rented both through and online marketplace and in some other way

The facts are the same as in Example | Tauira 1, with the exceptions noted below.

Hayley rents out the room for 120 nights in the income year. Sixty of those nights were rented out through an online marketplace and the remaining 60 were rented previous guests contacting Hayley directly.

In Example | Tauira 1, Hayley has calculated that she can deduct 15.62% of her mixed expenses for the income year.

However, because she is not GST-registered and has opted to treat the flat-rate credit as excluded income, she needs to deduct her expenses that that relate to the online marketplace nights on a GST-exclusive basis. Her expenses that relate to non-online marketplace nights (the direct bookings) are deducted on a GST-inclusive basis. The table below sets out Hayley's expenses and how she should calculate the deductions she can claim:

Expense	Amount	Amount apportioned to income-earning	Deduction
Commission charged by online marketplace	$180 (incl. GST)	100% = $180 (incl. GST)	$180 ÷ 1.15[7] = **$156.52 (excl. GST)**
Interest on her home loan for the property	$10,000 (GST exempt)	15.62% = $1,562	**$1,562**
Repairs and maintenance and other mixed expenses such as rates and property insurance	$10,000 (incl. GST)	15.62% = $1,562 (incl. GST)	*Online marketplace nights:* 60 (out of 120 rental nights). 60/120 x $1,562 = $781 (incl GST) ÷ 1.15 = **$679.13** (excl. GST) deduction for online marketplace nights *Non-online marketplace nights:* 60 (out of 120 rental nights). 60/120 x $1,562 = **$781** (incl. GST) deduction for non-online marketplace nights *Total deduction for repairs and maintenance:* $679.13 + $781 = **$1,460.13**

Online marketplace commission: Hayley does not need to apportion the commission charged by the online marketplace as it relates only to the rental activity. But her deduction must be claimed on a GST-exclusive basis. The $180 commission charged is divided by 1.15 to give a GST-exclusive deduction of **$156.52**.

7 Dividing the amount apportioned to income-earning by 1.15 gives you the GST-exclusive amount.

Interest on her home loan for the property: From the 2025-2026 income year, Hayley can claim up to 100% of the interest on her property loan. However, this interest needs to be apportioned between private use and income-earning use. Therefore, Hayley can deduct 15.62% of $10,000 which is **$1,562**. GST is not applied to interest, so there is no need for any further calculations for the online marketplace nights.

Repairs and maintenance and other mixed expenses: On the same basis as for interest, 15.62% of the $10,000 expense for repairs and maintenance, is attributable to income-earning. This is $1,562 (incl. GST).

The proportion of the expenses that relates to online marketplace nights is 50% (as 60 out of the 120 nights Hayley's home is rented out through an online marketplace), so $781 (incl. GST). This amount is then divided by 1.15 to give a GST-exclusive amount of $679.13 (excl. GST).

The proportion of the expenses that relates to non-online marketplace nights is also 50%, so $781 (incl. GST).

Therefore, the total amount of the repairs and maintenance and other mixed expenses deduction is **$1,460.13** ($679.13 + $781).

Hayley's total deduction in relation to the rental activity is therefore **$3,178.65** ($156.52 + $1,562 + $1,460.13).

If Hayley had opted to treat the flat-rate credit as assessable income, she would not need to undertake any apportionment for GST – all her expenses would be deductible on a GST-inclusive basis.

If you are GST-registered

40. If you are GST-registered, a flat-rate credit is not provided, and expenses and depreciation are deductible on a **GST-exclusive basis.**

Depreciation of chattels

41. As noted at [15], you can also claim deductions for the depreciation of the chattels in your home that paying guests can use. Depreciation deductions reflect that chattels in your home are subject to wear and tear, resulting in a reduction in their value while being used to earn income.

42. If the chattels are only used by guests (for example, chattels in a bedroom you only use for renting out), the full amount of depreciation will be deductible.

43. However, you can only claim for part of the depreciation on mixed-use chattels. Mixed-use chattels include chattels in common areas that guests are able to use, and chattels in a room you rent out and also use privately.

44. The approach to working out how much depreciation you can claim each year for mixed-use chattels is similar to the approach to apportioning mixed expenses. But it does differ slightly, as there is a specific apportionment formula in the Income Tax Act 2007 for depreciation of assets partly used to earn income.

45. Before you can apply the formula, you need to work out the depreciation loss for the income year for each asset.

46. For low value items ($1,000 or less),[8] the depreciation loss is the item's cost. If the item is part of a group of items you purchased at the same time from the same supplier, and the items would have the same depreciation rate, the $1,000 threshold applies to the group of items. For example, if you bought $2,000 worth of linen at one time, you would have to depreciate the linen using one of the methods mentioned at [47].

47. For other items, you work out the depreciation loss for the income year using either the diminishing value method or the straight-line method. There is information about those **methods** on Inland Revenue's website, and you can find the relevant depreciation rates using Inland Revenue's **depreciation rate finder** – available on Inland Revenue's website.

48. Whichever method you use, you cannot pool assets to depreciate them as a single asset if they are partly used privately – so you will not be able to use the pooled approach for the chattels in the common areas of your home that guests can use, or for chattels in a room you rent out and also use privately.

8 For items acquired on or after 17 March 2021.

49. Once you know the depreciation losses for the year for the chattels in your home that are both used privately and able to be used by paying guests, you need to work out what proportion of those losses you may deduct. To do this, multiply those losses by:

$$\frac{a + b}{c}$$

Where –

"a" is:	nights in the year the space (the room, or the whole house) is rented out
"b" is:	nights in the year the space is available to be rented out and the mixed-use chattels are not used privately
"c" is:	nights in the year the mixed-use chattels are used or available for any purpose

50. For mixed-use chattels in common areas, item "b" in the formula would typically be zero. This is because when the room you rent out is available for rent, you are still using the chattels in your lounge or other common areas for private use. However, this would not be the case if, for example, you were away overseas and renting out your whole house for short stays. In that situation, for the periods in between paying guests, you would not be using the chattels for private use, so those days the house is vacant would be counted in item "b". Example | Tauira 6 illustrates how to calculate a depreciation deduction for mixed-use chattels.

Example | Tauira 6 – Calculating a deduction for depreciation of mixed-use chattels

Jasper rents out the spare room in his house for short stays. When he has paying guests, they can use the lounge, dining room, kitchen, laundry and bathroom. Jasper rents out the room for a total of 120 nights during the year. Jasper does not use the spare room at all.

Jasper may deduct the full depreciation loss he calculates for the chattels in the spare room, as these are only used by paying guests.

Jasper calculates that he may deduct 16.44% of his depreciation losses in respect of the chattels in the common areas of the house that paying guests can use:

$$\frac{120}{365} \times 50 = 16.44\%$$

The formula is multiplied by 50 to recognise the private use of the chattels in common areas on nights when the spare room is rented out (see [27]). (Inland Revenue accepts 50% as a reasonable amount in most situations).

If Jasper was away for work for 30 nights during the year, the calculation would remain the same. While Jasper did not use the chattels in the common areas privately on those days, they were also not available to be used by paying guests, as Jasper only rents out the spare room when he is home.

51. If you are GST-registered, you calculate depreciation on the **GST-exclusive** price of the asset. If you are not registered for GST, you claim depreciation on the **GST-inclusive** price of the asset. This is the position, even if you have opted to treat the flat-rate credit as excluded income and rent your dwelling through an online marketplace.

Losses and the residential rental ring-fencing rules

52. If you rent out your home, a room in your home, or a separate dwelling on your property for short stays the residential rental ring-fencing rules are unlikely to apply.

53. The residential rental ring-fencing rules mean you can only claim deductions for expenses incurred on your property, up to the amount of income you earned from the property in the income year.[9] If your allowable deductions exceed the income from the property,[10] the excess deductions must be carried forward to future income years. You cannot offset the excess amount against other income, such as salary or wages.

9 Or, if the property is part of a portfolio of residential rental properties you own, you can only claim deductions for expenses incurred on the portfolio of properties up to the amount of income you earned from the portfolio in the income year.

10 Or portfolio of properties, if you have one.

54. However, these rules do not apply if you use more than 50% of the land for most of the income year as your main home (this is known as the "main home exclusion").[11] Your main home is the dwelling you use as a residence (or if you have more than one residence, the one you have the greatest connection with).

55. If you have a separate dwelling (such as a sleep-out or cottage) on the same land as your main home (for example, they are on the same legal title), as long as 50% of the land is used as your main home for most of the income year, the residential rental ring-fencing rules will not apply.

56. However, if you rent out a separate dwelling on your property and it is subject to the mixed-use asset rules, the mixed-use asset expenditure quarantine rules may apply if the rental activity is loss-making – see **QB 25/02**.

57. More details on the **residential rental ring-fencing rules** can be found on the Inland Revenue website or in the Appendix to **IS 23/04**: **The interest limitation rules and short-stay accommodation** (from A48).

Who must declare the income?

58. The rental income belongs to the owner of the land (including leasehold land) and they must declare it to Inland Revenue. If there is more than one owner, the income needs to be split appropriately between them.

59. If the land is owned in a trust, the rules about who must declare the income are more complicated. See **QB 25/05**: **Income tax – If property held in a trust is rented out for short-stay accommodation, who declares the income, and what deductions can be claimed?** for more detailed guidance.

60. If you lease the property and use it to earn income, you should ensure you are paying an adequate rent for the property to the extent you use the property for the income-earning. If you do not, in certain circumstances the Commissioner can determine an amount of adequate rent and you will be treated as deriving this amount as rental income (s GC 5). This rule ensures that property cannot be leased between (for example) relatives or different entities for low or nominal rent to shift income for a tax benefit.

What records do I need to keep?

61. You need to keep records of:

- the number of nights you rent out your home, room, or separate dwelling on your property;
- how much income you receive for renting out your home, room, or dwelling; and
- any expenses you may claim deductions for.

Provisional tax

62. If the residual income tax you have to pay at the end of the year, after you have filed your tax return, is more than $5,000, you will have to pay provisional tax the following year. This means you will pay your income tax in instalments during the year. The Inland Revenue website has further information about **provisional tax**.

11 The main home exclusion will also apply if the residential land is trust property and more than 50% of the land is used for most of the income year by a beneficiary of the trust as their main home and no principal settlor of the trust has a separate main home.

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QB 25/02: Income tax – Which rules apply if I have a dwelling I sometimes rent out as short-stay accommodation and also sometimes use privately?
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QB 25/02: Income tax – Which rules apply if I have a dwelling I sometimes rent out as short-stay accommodation and also sometimes use privately?

Issued | Tukuna: 3 April 2025

This question we've been asked (QWBA) helps you work out which income tax rules apply to a dwelling you sometimes rent out as short-stay accommodation (for example, through Airbnb, Bookabach, Booking.com or Holiday Houses) and also sometimes use privately (for example, as a holiday home).

REPLACES | WHAKAKAPIA:

- **QB 19/06**: What income tax rules apply if I have a dwelling that I sometimes rent out as short-stay accommodation and sometimes use myself? (Inland Revenue, 20 May 2019)

Question | Pātai

Which income tax rules apply if I have a dwelling I sometimes rent out as short-stay accommodation and also sometimes use privately?

Answer | Whakautu

Different rules could apply in this situation, and this can change from year to year. At the end of each income year, you need to work out which rules apply:

- the mixed-use asset rules; or
- the standard tax rules.

The rules that apply will determine the income tax treatment for that dwelling. The main difference between the mixed-use asset rules and the standard tax rules is how you calculate the proportion of expenses you can deduct.

This QWBA helps you work out which income tax rules apply to the dwelling for each income year. You need to revisit which rules apply each year.

Key terms | Kīanga tau tāpua

Guest means a person provided with short-stay accommodation in return for payment.

Mixed-use asset means an asset that is used both privately and to earn income and is also unused for at least 62 days in the year. This would include many holiday homes.

Short-stay accommodation means accommodation provided for up to four consecutive weeks in a dwelling that is not the guest's ordinary residence. It does not include accommodation provided to residential tenants, boarders or care home residents, and it does not include student or emergency accommodation.

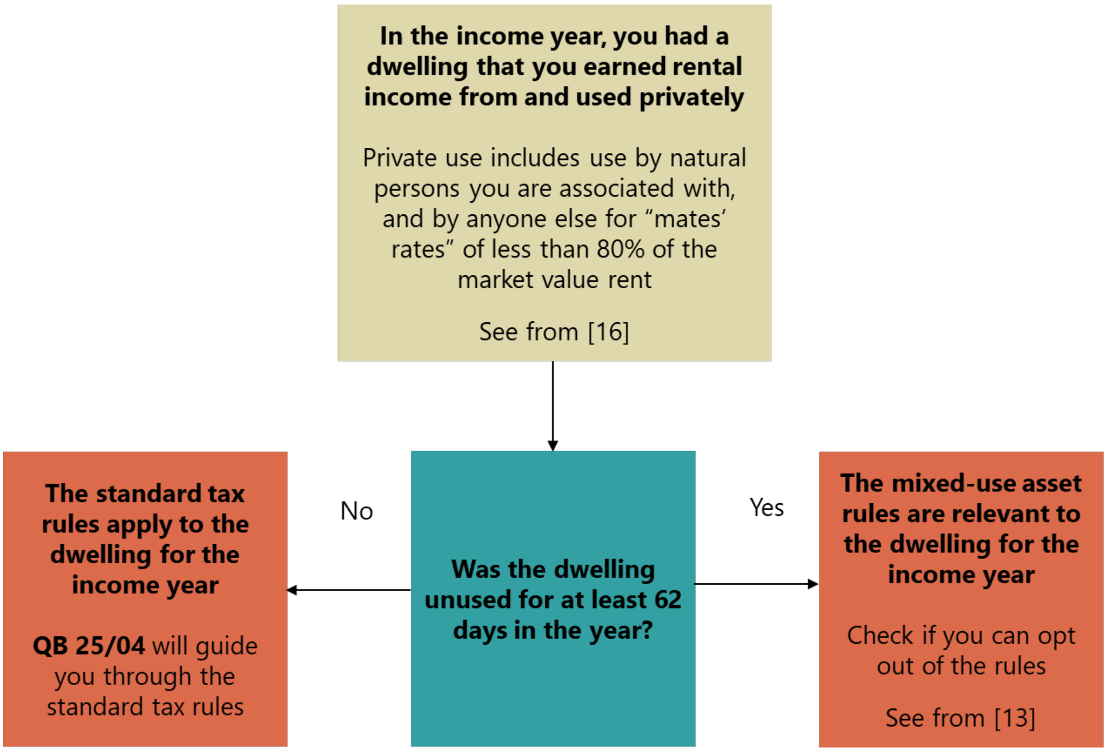
Explanation | Whakamāramatanga

1. If you have a dwelling you sometimes rent out as short-stay accommodation and also sometimes use privately, you need to work out which income tax rules apply so you can meet your tax obligations. The dwelling could be a holiday house or a separate dwelling on the same property you live on (for example, a sleepout or cottage).
2. Depending on your circumstances, the dwelling will either fall under:
   - the mixed-use asset rules; or
   - the standard tax rules.
3. This QWBA explains how to work out which income tax rules apply in your situation.

Mixed-use asset rules or standard tax rules?

4. The mixed-use asset rules deal with deductions for certain assets (including land) that are used both privately and to earn income but are also unused for significant periods during the year.
5. Under both the mixed-use asset rules and the standard tax rules, expenses that relate solely to the use of the asset to derive income are generally fully deductible and expenses that relate solely to private use of the asset are not deductible.
6. The main difference between the two sets of rules is the method for calculating the deductible proportion of expenses for the asset that relate to both income-earning and private use. Under the mixed-use asset rules, this is based on the amount of income-earning use relative to the total use of the asset during the income year. Under the standard tax rules, this is based on the amount of time the asset is used for income-earning or available for income-earning during the income year.
7. The factor that determines which rules apply is whether the asset is unused for 62 days or more during an income year.

Figure | Hoahoa 1 – Do the mixed-use asset rules or the standard tax rules apply?



8. A dwelling can flip in and out of the mixed-use asset rules from one year to the next, so you need to look at which rules are relevant to the dwelling for **each income year** (for most people this is 1 April – 31 March).[1] The mixed-use asset rules can apply to most ownership structures, so it does not matter if you own the property or if it is owned by another entity or held in another structure such as a trust or a family company.
9. The dwelling will be a mixed-use asset if, during the income year it was:
   - used it to earn income;
   - used privately (this includes use by family members, or by friends renting it for "mates' rates" that are less than 80% of the market value rent); and
   - not used for at least 62 days in the year.

Standard tax rules

10. If the dwelling does not meet the three criteria at [9] for an income year, the standard tax rules will apply. **QB 25/04: Income tax – How do the standard tax rules apply if I provide short-stay accommodation?** explains how the standard tax rules work. You need to revisit which rules apply each year.

1 Guidance on moving between the standard tax rules and the mixed-use asset rules can be found in **IS 25/08 Income tax – Implications of a residential property moving between the standard tax rules and the mixed-used asset rules**.

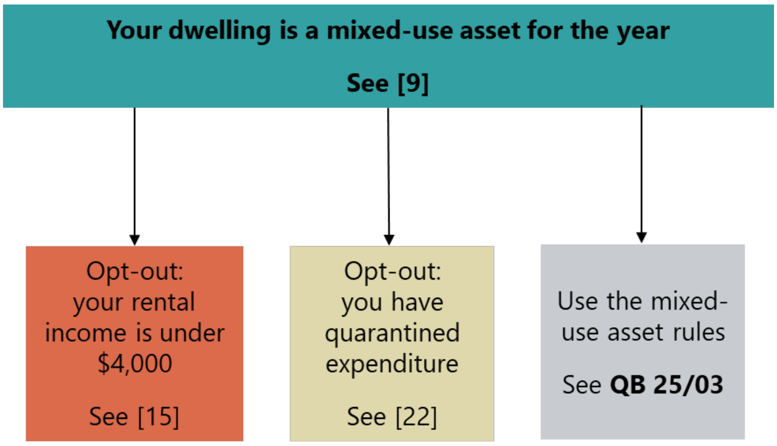
Mixed-use asset rules

11. If the dwelling meets the three criteria at [9] for an income year, the mixed-use asset rules are relevant. **QB 25/03: Income tax – How do the mixed-use asset rules apply if I provide short-stay accommodation?** explains how the mixed-use asset rules apply.
12. However, there are two situations where you can opt out of the mixed-use asset rules and the standard tax rules altogether for the rental income from the dwelling.

Opting out of the tax rules if the dwelling is a mixed-use asset

13. If the dwelling is a mixed-use asset, you can opt out of the mixed-use asset rules and the standard tax rules (collectively referred to in this QWBA as "the tax rules") if:
    - your rental income for the year from the dwelling is under $4,000; or
    - you made a loss from the dwelling and some of your deductions for the year would be quarantined (that is, carried forward to the next year) if you applied the mixed-use asset rules.

Figure | Hoahoa 2 – Opting out of the tax rules



14. If you choose to opt out of the tax rules for the rental income from the dwelling, the income is exempt. This means you do not pay tax on the rental income, and you cannot claim deductions for your expenses that relate to the dwelling.

Opt-out: rental income from the dwelling is under $4,000

15. You can opt out of the tax rules for the rental income from the dwelling where the gross rental income (before expense deductions) for the income year is under $4,000.
16. The $4,000 threshold for opting out of the tax rules **does not include** exempt income. Exempt income is income from renting out the dwelling to associated persons (for example, family members), and income from renting out the dwelling for less than 80% of the market value rent (for example, renting it to friends for "mates' rates"). This is explained in more detail from [17].

Income from renting to associated persons is exempt income

17. Income from renting out the dwelling to natural persons you are associated with (for example, close relatives such as your children, grandchildren, siblings or in-laws) is exempt income.
18. If a trust, partnership or company owns the dwelling, income from renting out the dwelling to associated natural persons (for example, for a trust, the settlors and beneficiaries) is exempt income.
19. **A guide to associated persons definitions for income tax purposes – IR620** can help you work out if someone is associated with you.

Income from renting at "mates' rates" is exempt income

20. Income from renting out the dwelling at "mates' rates" of less than 80% of the market value rent is exempt income.
21. This does not include income from renting out the dwelling at a lower price because it is off-peak season, a longer-term rental, or for other similar reasons. This is because in those situations the market rate is the lower price.

Opt-out: quarantined expenditure

22. You can also opt out of the tax rules for the rental income from the dwelling if for the income year you would have had quarantined expenditure under the mixed-use asset rules for the dwelling.
23. You would have had quarantined expenditure under the mixed-use asset rules if:
    - your income from renting out the dwelling during the income year was less than 2% of the property's value; and
    - you made a loss from renting out the dwelling (that is, the expenses you can deduct for the income year under the mixed-use asset rules exceed the income).
24. In this situation, if you **do not opt out** of the tax rules, you can only deduct your expenses for the dwelling up to the amount of the rental income. Your expenses over and above your income from the dwelling are "quarantined" – meaning they are carried forward to a future income year to offset against any future income from the dwelling.
25. Alternatively, you can **opt out** of the tax rules by treating the income for the year as exempt, and not claiming any deductions for your expenses related to the dwelling.
26. In working out if your income was less than 2% of the property's value, you **do not include** exempt income (amounts of income described in [16]). It is only your taxable income from the dwelling that counts towards the 2% threshold.
27. The property value you use to measure the 2% threshold against is generally the local rating value. However, if you bought the property from someone you are not associated with since the rates value was last set, you use the purchase price.
28. If there is another dwelling on the same property, the 2% threshold is measured against a proportion of the local rating valuation, based on the percentage of the total land area that the asset is on. For example, if you have a sleepout that is a mixed-use asset on the same property as your house, and the area of the sleepout is 20% of the total section, you measure the 2% threshold against 20% of the rating valuation.

If you decide to opt out

29. If one of above situations applies, and you choose to opt out of the tax rules for the rental income from the dwelling, you do not need to declare that income in your tax return for that income year. All the income from renting out the dwelling is classed as exempt income, and you cannot claim any related expenses as deductions.
30. For each income year, you need to revisit whether the dwelling is a mixed-use asset and if it is, whether you are able to opt out of the tax rules.

If you cannot or do not opt out

31. If the dwelling is a mixed-use asset and you cannot or do not opt out of the tax rules for the rental income, the mixed-use asset rules will apply for the income year. **QB 25/03** explains how the mixed-use asset rules work. You'll need to revisit which rules apply each income year.

What records do I need to keep?

32. You need to keep good records to work out each year which rules apply. This includes records of:
    - the number of nights the dwelling is used privately (this includes by you, by people you are associated with, and by anyone else if they pay less than 80% of the market value rent);
    - the number of nights you rent out the dwelling, and how much income you receive;
    - when the dwelling was available to be rented out (this will be relevant if the standard tax rules apply); and
    - any expenses you may claim deductions for.

References | Tohutoro

Other references | Tohutoro anō

A guide to associated persons definitions for income tax purposes – IR620 (guide, Inland Revenue, 2024)
ird.govt.nz/-/media/project/ir/home/documents/forms-and-guides/ir600---ir699/ir620/ir620-2024.pdf?modified=20240508212528&modified=20240508212528 (PDF 610KB)

QB 25/03: Income tax – How do the mixed-use asset rules apply if I provide short-stay accommodation?
taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2025/qb-25-03

QB 25/04: Income tax – How do the standard tax rules apply if I provide short-stay accommodation?
taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2025/qb-25-04

IS 25/08 Income tax – Implications of a residential property moving between the standard tax rules and the mixed-used asset rules
taxtechnical.ird.govt.nz/interpretation-statements/2025/is-25-08

QB 25/03: Income tax – How do the mixed-use asset rules apply if I provide short-stay accommodation?

Issued | Tukuna: 3 April 2025

This question we've been asked (QWBA) explains how the mixed-use asset rules apply to a dwelling you sometimes rent out as short-stay accommodation (for example, through Airbnb, Bookabach, Booking.com or Holiday Houses) and also sometimes use privately (for example, as a holiday home).

Before you use this QWBA, you need to work out if the mixed-use asset rules or the standard tax rules apply to the dwelling. **QB 25/02: Income tax – Which rules apply if I have a dwelling I sometimes rent out as short-stay accommodation and also sometimes use privately?** will help you work that out.

Key provisions | Whakaratonga tāpua

Income Tax Act 2007 – ss CC 1, CH 5B, DB 2, DG 9 and GC 5

REPLACES | WHAKAKAPIA:

- **QB 19/07**: How do the mixed-use asset income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately?

Question | Pātai

How do the mixed-use asset rules apply if I provide short-stay accommodation?

Answer | Whakautu

Where the mixed-use asset rules apply, rental income from the dwelling will generally be taxable. The only exceptions are:

- Income from renting the dwelling to associated persons (for example, family members) or to others at "mates' rates" (less than 80% of the market value rent), which is exempt income.
- Any flat-rate credits you receive from an online marketplace operator, which you have opted to treat as excluded income.

The mixed-use asset rules set out how to calculate the proportion of expenses you can deduct against your income from providing the short-stay accommodation.

Expenses that relate solely to renting out the dwelling (for example, advertising) are generally fully deductible. Expenses that relate solely to your private use of the dwelling are not deductible. Expenses that relate both to income-earning and private use are partly deductible – the deductible proportion is based on the number of rental nights relative to the total number of nights the dwelling is used during the year.

If you are not GST-registered and have opted to treat the flat-rate credit as excluded income, expenses that relate to rental income from an online marketplace are deductible on a GST-exclusive basis and expenses that relate to rental income from other sources are deductible on a GST-inclusive basis. However, if you have opted to treat the flat-rate credit as assessable income, all your expenses that relate to rental income (from an online marketplace or otherwise) are deductible on a GST-inclusive basis.

If you are GST registered, expenses are deductible on a GST-exclusive basis.

If you make a loss from renting out the dwelling, you may not be able to deduct all your expenses that income year – some of your deductions might have to be carried forward to future income years.

Key terms | Kīanga tau tāpua

Guest means a person provided with short-stay accommodation in return for payment.

Mixed-use asset means an asset that is used both privately and to earn income and is also unused for at least 62 days in the year. This would include many holiday homes.

Online marketplace means an electronic platform like a website, app or internet portal that sellers use to market and sell their short-stay accommodation. It does not include an online marketplace that only processes payments.

Short-stay accommodation means accommodation provided for up to four consecutive weeks in a dwelling that is not the guest's ordinary residence. It does not include accommodation provided to residential tenants, boarders or care home residents, and it does not include student or emergency accommodation.

Explanation | Whakamāramatanga

1. If you have a dwelling you sometimes rent out as short-stay accommodation and also sometimes use yourself, you need to work out which income tax rules apply, so you can meet your tax obligations. The dwelling could be a holiday house, or a separate dwelling on the same property you live on (for example, a sleep-out or cottage). [1]
2. Depending on your circumstances, the dwelling will either fall under:
   - the mixed-use asset rules; or
   - the standard tax rules.
3. To work out which rules apply in your situation, see **QB 25/02**: **Income tax – Which rules apply if I have a dwelling I sometimes rent out as short-stay accommodation and also sometimes use privately?** You need to revisit which rules apply each income year (for most people this is 1 April – 31 March).[2]
4. This QWBA is relevant if:
   - you have determined that for a particular income year the dwelling is a mixed-use asset; and
   - you have not opted out of the tax rules. You can only opt out in certain circumstances – see QB 25/02.
5. This QWBA does not apply if the dwelling is owned by a company.

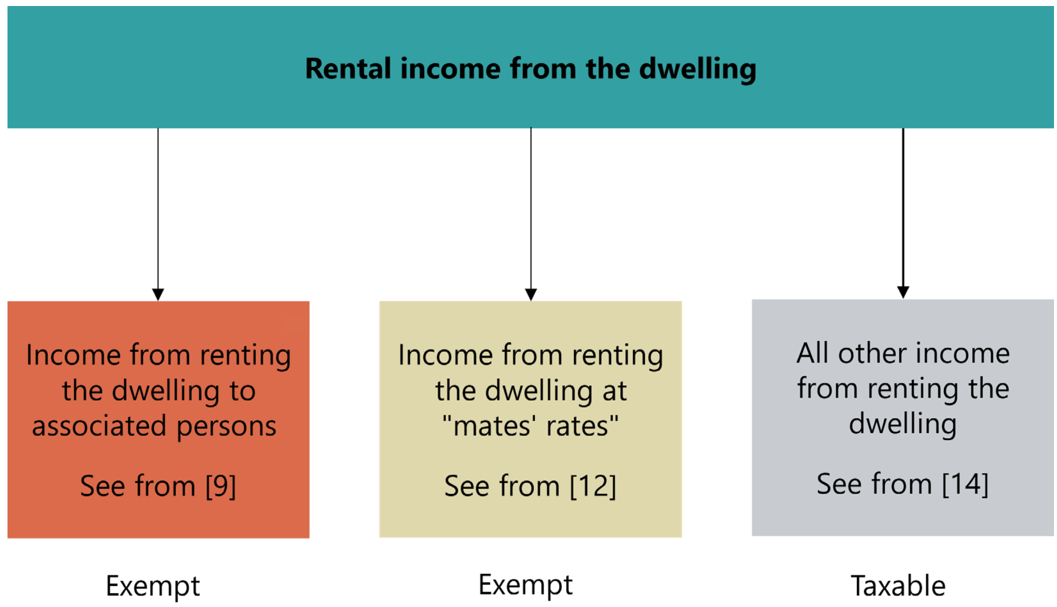
What rental income is taxable and what rental income is exempt?

6. Income you receive from renting out the dwelling is generally taxable. However, there are two situations where it will be exempt income:
   - When it is income from renting to associated persons.
   - When it is income from renting at "mates' rates".
7. You do not pay tax on exempt income, and you cannot deduct expenses that relate solely to days the dwelling is used to derive exempt income. Days that you derive exempt income are taken into account in the formula for calculating the proportion of partly deductible expenses you can claim (see from [31]).
8. Figure | Hoahoa 1 summarises what you need to consider when working out whether your rental income is taxable or exempt.

1 There could be situations where the mixed-use asset rules apply to your home because it has been unused for more than 62 days in the income year. But generally, if you provide short-stay accommodation in your home, **QB 25/01** will be relevant.

2 Guidance on moving between the standard tax rules and the mixed-use asset rules can be found in **IS 25/08: Income tax – implications of a residential property moving between the standard tax rules and the mixed-used asset rules.**

Figure | Hoahoa 1 – Is my rental income taxable or exempt?



Exempt income: renting out the dwelling to an associated person

9. Income you receive from renting out the dwelling is exempt where you rent the dwelling out to a natural person who is associated with you (such as close relatives like your children, grandchildren, siblings, or in-laws). This is the outcome, even if you rent it out to an associated person at market value rent.

10. If a trust or partnership owns the dwelling, income from renting out the dwelling to associated natural persons (for example, for a trust, the settlors and beneficiaries) is exempt income.

11. **A guide to associated persons definitions for income tax purposes – IR620** can help you work out if someone is associated with you.

Exempt income: renting out the dwelling at "mates' rates"

12. Income you receive from renting out the dwelling is exempt where you rent it out for less than 80% of the market value rent. This includes income from renting the dwelling to friends at "mates' rates" of less than 80% of the market value rent.

13. It does not include income from renting out the dwelling at a lower price because it is off-peak season, a longer-term rental, or other similar reasons. This is because in those situations the market rate is the lower price.

Taxable rental income

14. Other than the two situations mentioned at [9] and [12], any amounts you receive from renting out the dwelling are taxable. The activity does not need to be run as a business for the amounts you receive to be income.

15. You will be able to deduct expenses related to the dwelling. The discussion from [25] explains how to work out what proportion of expenses is deductible.

Treatment of any flat-rate credits received from an online marketplace operator

16. If you are not GST-registered and list your dwelling through an online marketplace like AirBnB, Bookabach, Booking.com or Holiday Homes, the marketplace operator will give you a flat-rate credit of 8.5% of the value of your supply of short-stay accommodation.

17. You have the option to treat the flat-rate credit as either:

    - excluded income (which is not subject to income tax, so is not included in your income tax return); or
    - assessable income (which is included in your income tax return).

    (Section CH 5B).

18. The option you choose will have implications for how you deduct expenses (see from [39]).

19. The flat-rate credit is intended to recognise the GST on your expenses that, if you were GST-registered, you would be able to deduct as input tax in your GST return on any supplies of goods and services that you bought to make supplies of short-stay accommodation.
20. If you are GST-registered and list your dwelling through an online marketplace, you will not receive a flat-rate credit. This is because you can deduct input tax from your actual expenses incurred in making supplies of short-stay accommodation.
21. You must notify your online marketplace operator of your GST registration status and any changes in that status, so they can work out whether they need to pay you the flat-rate credit.

What portion of my expenses can I claim deductions for?

22. The starting point is that you can fully deduct non-capital expenses that relate solely to your rental activity. Any expenses that relate solely to private use of the dwelling are not deductible. Private use includes use by you, by natural persons you are associated with, and by anyone for less than 80% of the market value rent. Many of your expenses will relate to both your income-earning and private use of the dwelling (for example, rates, loan interest and property insurance) – these mixed expenses are only partly deductible.[3]
23. It is important to note that if you are not GST-registered and opt to treat the flat-rate credit as excluded income, any expenses that relate to nights when the dwelling was rented through an online marketplace must be deducted on a **GST-exclusive** basis. Expenses that relate to nights when the dwelling was rented out other than through an online marketplace are deductible on a **GST-inclusive basis**. However, if you opt to treat the flat-rate credit as assessable income, all your expenses are deducted on a **GST-inclusive basis**.
24. If you are GST-registered, you deduct your expenses on a **GST-exclusive** basis. This is discussed in more detail in Example | Tauira 2.

Expenses that may be fully deductible – relate solely to rental activity

25. You may be allowed to fully deduct some expenses. To be fully deductible, the expense (which cannot be a capital expense) must:
    - relate solely to the use of the dwelling to derive income (not including exempt income), and
    - meet either or both of the following:
        - be an expense you would not reasonably expect to receive a personal benefit from;

          and / or
        - be an expense you must reasonably incur to meet a regulatory requirement to be able to use the dwelling to derive income, and you would not have incurred the expense otherwise.
26. These expenses might include:
    - advertising costs, including any commissions or fees you pay to an advertising platform or transaction facilitator (this does not include any service fees the guests pay the platform – just fees you pay);
    - supplies used solely by your paying guests (for example, if you provide them with a welcome basket of breakfast food or chocolates);
    - cleaning costs for the rental periods;
    - any additional property or contents insurance premium you pay (over what you would otherwise pay) because the property is used for short-stay accommodation; and
    - any additional rates you pay (over what the normal residential rates would be) because the property is used for short-stay accommodation.[4]

3 For a list of deductible and non-deductible rental property expenses, go to www.ird.govt.nz and search “rental property expenses”.

4 Some councils may impose targeted rates in respect of properties used for short-stay accommodation.

27. You may have some expenses that you can split between being related solely to your rental activity and being mixed rental and private expenses. For example, expenses that have a fixed component and a usage component, like power. Mixed expenses usually need to be apportioned. However, if you can identify actual usage charges for a period where the dwelling was only rented out and not used privately at all, you do not have to apportion the usage component for that period – it is fully deductible. You might want to do this, for example, if there is a period where the usage component of an expense is higher than usual. For example, you rent your dwelling for three consecutive weeks during the winter and there is higher than usual power usage during those weeks as the guests use additional heating and appliances like the drier. However, the fixed charge component must be apportioned, as it is necessary to maintain a power connection, which is used both privately and by paying guests. While this approach might result in a larger deduction, it is not compulsory, and you may find it simpler to apportion the total expense for the year (both the fixed and usage components) between private use and income-earning use for the year.
28. You may also be allowed to fully deduct the cost of repairing damage to the property that occurred when it was being used to earn income. This does not include when the property is used to earn exempt income (the two situations mentioned at [6]). It also does not include damage that is the result of ordinary wear and tear, as that occurs during periods the dwelling is rented and periods it is used privately.
29. While the starting point is that the above expenses may be fully deductible, if you rent the dwelling through an online marketplace, your deduction may need to be claimed on a GST-exclusive basis. This is discussed from [39].

Expenses that are non-deductible – relate solely to private use

30. Expenses that relate solely to the private use of the dwelling are not deductible. Private use includes use by you, by natural persons you are associated with, and by anyone for less than 80% of the market value rent. For example, if you use the dwelling for a month over the summer and you can identify actual usage charges that are a component of some of your expenses (for example, power), you cannot deduct any of the usage component for that period as it relates solely to your private use of the dwelling. Similarly, any consumables you use at the dwelling are not deductible. However, if you have consumables you use at the dwelling that are also available for guests to use (for example, tea, coffee, olive oil, shampoo, and soap), those consumables are partly deductible.

Expenses that are partly deductible – relate to both rental activity and private use

31. All your other deductible expenses must be apportioned between the income-earning use of the dwelling, and the private use of the dwelling. This might include expenses such as:
    - interest on your loan for the property;[5]
    - repairs and maintenance;[6]
    - property and contents insurance premiums (excluding any additional premium imposed because the property is used for short-stay accommodation – as noted at [26], those amounts will be fully deductible);
    - rates (excluding any targeted rates imposed by councils because the property is used for short-stay accommodation – as noted at [26], those amounts will be fully deductible);
    - power bills (but see [27] and [30]);
    - internet; and
    - depreciation on chattels.
32. There is a formula in the mixed-use asset rules to use to apportion these expenses, so you know what proportion is deductible. Under the formula, the proportion of expenses that are deductible reflects the income-earning use of the dwelling relative to the private use. Only days the dwelling is actually used are counted, so days the dwelling is available to be rented out but is not actually rented out do not alter the proportion of expenses you can deduct.
33. For example, if the dwelling was used privately for 30 nights in a particular income year, and rented out for 25 nights, you could deduct 45.45% of your expenses (25 income-earning nights out of a total of 55 nights the dwelling was used).

5 From 1 April 2024, up to 80% of the interest can be claimed, and from 1 April 2025 up to 100% of the interest can be claimed. The actual amount claimed needs to be apportioned to account for any private use.

6 Deductible repairs and maintenance expenditure does not include expenditure on capital improvements (see **IS 12/03: Income tax – Deductibility of repairs and maintenance expenditure – general principles**).

34. The formula (in s DG 9 of the Income Tax Act 2007) refers to "days", but if a different unit of measure would give a more appropriate apportionment, you use that measure instead. For accommodation, "nights" is the appropriate measure to use. Therefore, the formula is:

$$\text{your expenditure x} \quad \frac{\text{income-earning nights}}{\text{income-earning nights + counted nights}}$$

35. "Income-earning nights" are:

- **Nights the dwelling is used to earn income, other than exempt income**

  Nights where you rent out the dwelling to someone who is associated with you or for "mates' rates" (less than 80% of the market value rent, discussed from [12]) are **not counted** as income-earning nights.

- **Nights you use the dwelling to repair damage caused by a guest**

  This **does not include** nights you stay at the dwelling to repair damage caused by guests you get exempt income from (mentioned at [9] and [12] – associated persons and people paying "mates' rates"). It also **does not include** nights you stay at the dwelling to repair damage that is the result of ordinary wear and tear.

  Your use of the dwelling to carry out the repairs must be necessary for you to be able to count those nights as income-earning nights. Therefore, you can only count the nights you need to stay at the dwelling to complete the repairs from damage caused on an income-earning night.

- **Nights the dwelling was reserved by someone who did not end up using it**

  These nights may be counted as income-earning nights if the dwelling is not available for use because the person who reserved it did not end up using it. For example, a no-show, or a cancellation close to the reserved date which means the dwelling cannot be used by someone else.

36. "Counted nights" are:

- **Nights the dwelling is used, but are not income-earning nights.**

  This includes nights you use the dwelling, nights someone associated with you uses the dwelling, and nights the dwelling is rented out for less than 80% of the market value rent.

37. Table | Tūtohi 1 provides some examples of income-earning nights and counted nights.

Table | Tūtohi 1 – Examples of income-earning nights and counted nights

Income-earning nights	Counted nights
• You rent the dwelling to a non-associated person at market rates. • A non-associated guest paying market rates damages the dwelling and you stay there for two nights repairing the damage. • A guest cancels the day before their 3-night booking and no one else books the dwelling for those nights.	• You stay at the dwelling for a holiday. • You rent the dwelling to your in-laws at market rates. • You rent the dwelling to your best friend for "mates' rates" of $50 a night rather than the usual price of $100. • Your friend who stayed at "mates' rates" damages the dwelling and you stay there for two nights repairing the damage. • The paint in the bedrooms is looking shabby, so you stay at the dwelling for a week re-painting.

Income-earning nights	Counted nights
	• A non-associated guest paying market rates damages the dwelling. After staying at the property for two nights repairing the damage you decide to stay on for three more nights. The three additional nights are counted nights. • A non-associated guest paying market rates damages the dwelling, but the damage is only minor and you fix it in a couple of hours on your next family holiday at the dwelling.

38. Example | Tauira 1 shows how the apportionment formula works. If you do not want to do the calculations yourself, there is a **mixed-use asset calculator** on Inland Revenue's website that you can use to work out how much you can deduct for the expenses that need to be apportioned (for example, the expenses listed at [31]).

Example | Tauira 1 – Using the mixed-use asset apportionment formula

Matt's holiday home has a rating value of $300,000. He bought the holiday home before the last time the rating value was reset.

Matt rented out his holiday home for 20 nights in the income year, at $200 a night, through his own website (which is not an online marketplace). All of the rental nights were to people Matt is not associated with and were at full market rate. Matt used the holiday home for 35 nights, and his brother (an associated person) used it for 12 nights.

Matt's fully deductible expenses (which relate solely to the rental use of the holiday home) for the year were **$230** for advertising, and a total of **$500** for cleaning services after each guest (not including associates or friends paying "mates' rates").

Matt does not have any expenses that relate solely to his private use of the holiday home.

The expenses Matt has that relate to both the rental activity and the private use of the holiday home total $10,000 (which includes interest on Matt's loan for the property, rates, insurance, utility bills and general maintenance). Using the apportionment formula, Matt calculates that he can deduct **$2,985.07** of those expenses:

$$\$10{,}000 \quad \text{x} \quad \frac{20}{67} = \$2{,}985.07$$

So, the total amount Matt can deduct is **$3,715.07** ($230 + $500 + $2,985.07).

His total income from renting out the holiday home was **$4,000** (20 nights × $200).

Therefore, Matt has a net profit of **$284.93** for the dwelling for the income year.

Are my expenses deducted on a GST-inclusive or GST-exclusive basis?

39. If you are GST-registered, you deduct your expenses on a **GST-exclusive** basis.

40. If you are not GST-registered and have opted to treat the flat-rate credit as assessable income, you deduct your expenses on a **GST-inclusive basis** (s DB 2).

41. If you are not GST-registered and have opted to treat the flat-rate credit as excluded income:

- Expenses that relate to nights when the dwelling was rented through an online marketplace are deducted on a **GST-exclusive** basis. This is because the flat-rate credit you receive from the online marketplace is intended to recognise the GST on the expenses you incur when deriving this income, that you would be able to deduct as input tax in your GST return if you were GST-registered.
- Expenses that relate to nights when the dwelling was rented out other than through an online marketplace, are deducted on a **GST-inclusive** basis.

(Section DB 2).

42. If you are not GST-registered and have opted to treat the flat-rate credit as excluded income, you may need to apportion your expenses. If you have expenses that relate to both nights when the dwelling was rented out through an online marketplace and nights when the dwelling was rented out other than through an online marketplace, these expenses need to be apportioned. Example | Tauira 2 explains how to do this.

Example | Tauira 2 – Apportioning expenses where a person is not GST-registered, has opted to treat the flat-rate credit as excluded income, and their dwelling is rented both through an online marketplace and in some other way

The facts are the same as in Example | Tauira 1, with the exceptions noted below.

For the 2025-2026 income year, Matt rented out his holiday home for 20 nights, at $200 a night. All of the rental nights were to people Matt is not associated with, and were at full market rate.

Ten of those nights were rented through an online marketplace and 10 were rented through Matt's own website (which is not an online marketplace).

Matt used the holiday home for 35 nights, and his brother (an associated person) used it for 12 nights.

This is summarised in the table below:

Use	Number of nights
Private use	47
Rented through online marketplace	10
Rented through website	10

Because Matt is not GST-registered and has opted to treat the flat-rate credit as excluded income, he needs to deduct his expenses that relate to the online marketplace nights on a GST-exclusive basis. His expenses that relate to non-online marketplace nights are deducted on a GST-inclusive basis. The table below sets out Matt's expenses and how he should calculate the deductions he can claim:

Expense	Amount	Amount apportioned to income-earning	Deduction
Commission charged by online marketplace	$60 (incl. GST)	100% = $60 (incl. GST)	$60 ÷ 1.15[7] = **$52.17 (excl. GST)**
Interest on loan for the property	$20,000 (GST exempt)	29.85% (20/67) =$5,970	**$5,970**
Repairs and maintenance and other mixed expenses such as rates and property insurance	$10,000 (incl. GST)	29.85% (20/67) = $2,985 (incl. GST)	*Online marketplace nights:* 10 nights (out of 20 rental nights). 10/20 x $2,985 = $1,492.50 (incl. GST) ÷ 1.15 = **$1,297.83 (excl. GST)** deduction for online marketplace nights. *Non-online marketplace (Matt's website) nights:* 10 nights (out of 20 rental nights). 10/20 x $2,985 = $1,492.50 **$1,492.50 (incl. GST)** deduction for non-online marketplace nights. *Total deduction for repairs and maintenance:* $1,297.83 + $1,492.50 = **$2,790.33**

7 Dividing the amount apportioned to income-earning by 1.15 gives you the GST-exclusive amount.

Online marketplace commission: Matt does not need to apportion the commission charged by the online marketplace as it relates only to the rental activity. But his deduction must be claimed on a GST-exclusive basis. The $60 commission charged is divided by 1.15 to give a GST-exclusive deduction of **$52.17**.

Interest on loan for the property: From the 2025-2026 income year, Matt can claim up to 100% of the interest on his property loan. However, this interest needs to be apportioned between private use and income-earning use. As discussed in this QWBA, under the mixed-use asset rules this is done based on the amount of income-earning use relative to the total use of the asset during the income year. For the income year, there are 20 income-earning nights and 67 total use nights. Therefore, Matt can deduct 29.85% (20/67) of $20,000 which is **$5,970.15**. GST is not applied to interest, so there is no need for any further calculations for the online marketplace nights.

Repairs and maintenance and other mixed expenses: On the same basis as for interest, 29.85% of the $10,000 expense for repairs and maintenance and other mixed expenses is attributable to income-earning. This is $2,985 (incl. GST).

The proportion of the expenses attributable to income-earning that relates to online marketplace nights is 50% (as 10 out of the 20 rental nights are online marketplace nights), so $1,492.50. This amount is then divided by 1.15 to give a GST-exclusive amount of $1,297.83.

The proportion of the expenses attributable to income-earning that relates to non-online marketplace nights (50%) is $1,492.50 (incl. GST).

Therefore, the total amount of the repairs and maintenance deduction is **$2,790.33** ($1,297.83 + $1,492.50).

Matt's total deduction in relation to the rental activity is therefore **$8,812.65** ($52.17 + $5,970.15 + $2,790.33).

If Matt had opted to treat the flat-rate credit as assessable income, he would not need to undertake any apportionment – all his expenses would be deductible on a GST-inclusive basis.

Losses and the mixed-use asset expenditure quarantine rules

43. The residential ring-fencing rules do not apply to mixed-use assets. However, there are specific rules for loss-making mixed-use assets that may apply. These rules are called the mixed-use asset expenditure quarantine rules. Under these rules, if you make a loss from renting out the dwelling (that is, the deductible expenses for the year exceeded the rental income), you might not be allowed to deduct all your expenses for that income year.
44. If the mixed-use asset expenditure quarantine rules apply, you can only deduct your expenses up to the amount of the rental income from the dwelling. Any deductions in excess of that are carried forward to future income years until they are able to be offset against any future profits from the dwelling.
45. The mixed-use asset expenditure quarantine rules apply if:
    - your income from renting out the dwelling during the income year was less than 2% of the property's value; and
    - you made a loss from renting out the dwelling (that is, the deductible expenses for the year exceeded the income).
46. In working out if your income was less than 2% of the property's value, you **do not include** exempt income. It is your taxable income from the dwelling that must meet the 2% threshold.
47. The property value you use to measure the 2% threshold against is generally the local rating value. However, if you bought the property from someone you are not associated with since the rates value was last set, you use the purchase price. This is illustrated in Example | Tauira 3.

Example | Tauira 3 – The mixed-use asset expenditure quarantine rules

The facts are the same as in Example | Tauira 1. However, Matt has deductions of **$6,700.15** and therefore a net loss of **-$2,700.15**.

Matt's holiday home has a rating value of $300,000. Two percent of the property value for the holiday home is $6,000. Because Matt's income from renting the holiday home ($4,000) is less than that, he can only deduct expenses up to the amount of income – so $4,000 worth. The remaining deductible expenses ($2,700.15) are carried forward to the next income year.

48. If you would otherwise have quarantined expenditure for an income year, you may instead choose to opt out of the mixed-use asset rules. This is discussed in **QB 25/02**. If you do this, all the income from renting out the dwelling is exempt income, and you cannot claim any related expenses as deductions.

Who must declare the income?

49. The rental income belongs to the owner of the land (including leasehold land) and they must declare it to Inland Revenue. If there is more than one owner, the income needs to be split appropriately between them.

50. If the dwelling is owned in a trust, the rules about who must declare the income are more complicated. You should refer to **QB 25/05**: **If property held in a trust is rented out for short-stay accommodation, who should declare the income, and what deductions can be claimed?** for more detailed guidance.

51. If you lease the property and use it to earn income, you should ensure you are paying an adequate rent for the property to the extent you use the property for income-earning. If you do not, in certain circumstances the Commissioner can determine an amount of adequate rent and you will be treated as deriving this amount as rental income (s GC 5). This rule ensures that property cannot be leased between (for example) relatives or different entities for low or nominal rent to shift income for a tax benefit.

What records do I need to keep?

52. Because the dwelling may or may not fall within the mixed-use asset rules (remember, you need to work out each year whether it does), you need to keep good records so you can apply the income tax rules correctly. This includes records of:

- the number of nights you rent out the dwelling at market value, and how much income you receive;
- the number of nights you rent out the dwelling at "mates' rates", and how much income you receive;
- the number of nights you, or people you are associated with, used the dwelling;
- when the dwelling was available to be rented out (this will be relevant if the standard tax rules apply);
- any expenses you may claim deductions for; and
- any quarantined expenditure you have in respect of the dwelling.

Provisional tax

53. If the residual income tax you have to pay at the end of the year, after you have filed your tax return, is more than $5,000, you will have to pay provisional tax the following year. This means you will pay your income tax in instalments during the year. The Inland Revenue website has further information about **provisional tax**.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Income Tax Act 2007 – ss CC 1, CH 5B, s DB 2, DG 9 and GC 5.

Other references | Tohutoro anō

A guide to associated persons definitions for income tax purposes – IR620 (guide, Inland Revenue, 2024)
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QB 25/04: Income tax – How do the standard tax rules apply if I provide short-stay accommodation?

Issued | Tukuna: 3 April 2025

This question we've been asked (QWBA) explains how the standard tax rules apply to a dwelling you sometimes rent out as short-stay accommodation (for example, through Airbnb, Bookabach, Booking.com or Holiday Houses) and also sometimes use privately (for example, as a holiday home).

Before you use this QWBA, you need to work out if the standard tax rules or the mixed-use asset rules apply to the dwelling. **QB 25/02: Income tax – Which rules apply if I have a dwelling I sometimes rent out as short-stay accommodation and also sometimes use privately?** will help you work that out.

Key provisions | Whakaratonga tāpua

Income Tax Act 2007 – ss CC 1, CH 5B, DB 2 and GC 5

REPLACES | WHAKAKAPIA:

- **QB 19/08:** How do the standard income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately?

Question | Pātai

How do the standard tax rules apply if I provide short-stay accommodation?

Answer | Whakautu

Where the standard tax rules apply, rental income from the dwelling will generally be taxable, including "mates' rates" rental income. The only exceptions are:

- Minor contributions to expenses from family and friends, which are exempt income.
- Any flat-rate credits you receive from an online marketplace operator, which you have opted to treat as excluded income.

Expenses that relate solely to renting out the dwelling (for example, advertising) are generally fully deductible. Expenses that relate solely to your private use of the dwelling are not deductible. Expenses that relate to both income-earning and private use are partly deductible – the deductible proportion is based on the number of nights the dwelling is rented or available to be rented, relative to the total number of nights in the year.

If you are not GST-registered and have opted to treat the flat-rate credit as excluded income, expenses that relate to rental income from an online marketplace are deductible on a GST-exclusive basis and expenses that relate to rental income from other sources are deductible on a GST-inclusive basis. However, if you have opted to treat the flat-rate credit as assessable income, all your expenses that relate to rental income (from an online marketplace or otherwise) are deductible on a GST-inclusive basis.

If you are GST-registered, expenses are deductible on a GST-exclusive basis.

If you make a loss from renting out the dwelling, you may not be able to deduct all your expenses that income year – some of your deductions might have to be carried forward to future income years.

Key terms | Kīanga tau tāpua

Guest means a person provided with short-stay accommodation in return for payment.

Online marketplace means an electronic platform like a website, app or internet portal that sellers use to market and sell their short-stay accommodation. It does not include an online marketplace that only processes payments.

Short-stay accommodation means accommodation provided for up to four consecutive weeks in a dwelling that is not the guest's ordinary residence. It does not include accommodation provided to residential tenants, boarders or care home residents, and it does not include student or emergency accommodation.

Explanation | Whakamāramatanga

1. If you have a dwelling you sometimes rent out as short-stay accommodation and also sometimes use yourself, you need to work out which income tax rules apply, so you can meet your tax obligations. The dwelling could be a holiday house, or a separate dwelling on the same property you live on (for example, a sleepout or cottage).
2. Depending on your circumstances, the dwelling will either fall under:
   - the mixed-use asset rules; or
   - the standard tax rules.
3. To work out which rules apply in your situation see **QB 25/02**: **Income tax – Which rules apply if I have a dwelling I sometimes rent out as short-stay accommodation and also sometimes use privately?** You need to revisit which rules apply each income year (for most people this is 1 April – 31 March).[1]
4. This QWBA is relevant if you have determined that for a particular income year the dwelling is subject to the standard tax rules.
5. This QWBA does not apply if the dwelling is owned by a company.

What rental income is taxable and what rental income is exempt?

Taxable rental income: amounts received from paying guests

6. Amounts you receive from paying guests will generally be taxable income under s CC 1 of the Income Tax Act 2007. The activity does not need to be run as a business for the amounts you receive to be income.
7. You will be able to deduct expenses related to the dwelling. The discussion from [16] explains how to work out what proportion of expenses is deductible.

Taxable rental income: renting the dwelling at "mates' rates"

8. If you rent the dwelling at less than full market rent (for example, to family or friends at "mates' rates"), the rent will be taxable income. In this situation, Inland Revenue will accept a deduction for your expenses for those nights up to the amount of rent received for those nights.

Exempt income: minor contributions to expenses

9. Amounts you receive from family or friends who use the dwelling and are not charged rent but make a minor contribution to your expenses (for example, they pay you $20 towards power and heating) are exempt income. In that situation, the contribution is not taxable rental income, and you cannot claim any deductions for those nights.

Treatment of any flat-rate credits received from an online marketplace operator

10. If you are not GST-registered and list your dwelling through an online marketplace like AirBnB, Bookabach, Booking.com or Holiday Homes, the marketplace operator will give you a flat-rate credit of 8.5% of the value of your supply of short-stay accommodation.

1 Guidance on moving between the standard tax rules and the mixed-use asset rules can be found in **IS 25/08: Income tax – Implications of a residential property moving between the standard tax rules and the mixed-used asset rules**.

11. You have the option to treat the flat-rate credit as either:
    - excluded income (which is not subject to income tax, so is not included in your income tax return); or
    - assessable income (which is included in your income tax return).

    (Section CH 5B).
12. The option you choose will have implications for how you deduct expenses (see from [32]).
13. The flat-rate credit is intended to recognise the GST on your expenses that, if you were GST-registered, you would be able to deduct as input tax in your GST return on any supplies of goods and services that you bought to make supplies of short-stay accommodation.
14. If you are GST-registered and list your dwelling through an online marketplace, you will not receive a flat-rate credit. This is because you can deduct input tax from your expenses incurred in making supplies of short-stay accommodation.
15. You must notify your online marketplace operator of your GST registration status and any changes in that status, so they can work out whether they need to pay you the flat-rate credit.

What portion of my expenses can I claim deductions for?

16. The starting point is that you can fully deduct non-capital expenses that relate solely to your rental activity. Any expenses that relate solely to private use of the dwelling are not deductible. Private use includes use by you and by natural persons you are associated with but who are not charged rent. Many of your expenses will relate to both your income-earning and private use of the dwelling (for example, rates, loan interest and property insurance) – these mixed expenses are only partly deductible.[2]
17. A guide to associated persons definitions for income tax purposes – **IR620** can help you work out if someone is associated with you.
18. You will also be able to claim deductions for the depreciation of the chattels in the dwelling that paying guests can use. But, as with your mixed expenses, you can only claim for part of the depreciation because the chattels are used when the dwelling is rented out to earn income and also when it is used privately.
19. It is important to note that if you are not GST-registered and opt to treat the flat-rate credit as excluded income, any expenses that relate to nights when the dwelling was rented through an online marketplace must be deducted on a **GST-exclusive** basis. Expenses that relate to nights when the dwelling was rented out other than through an online marketplace are deductible on a **GST-inclusive** basis. However, if you opt to treat the flat-rate credit as assessable income, all your expenses are deducted on a **GST-inclusive basis** (s DB 2).
20. If you are GST-registered, you deduct your expenses on a **GST-exclusive** basis. This is discussed in more detail in Example | Tauira 3.

Expenses that may be fully deductible – relate solely to rental activity

21. You may be allowed to fully deduct expenses that relate solely to your rental activity. These expenses might include:
    - advertising costs, including any commissions or fees you pay to an advertising platform or transaction facilitator (this does not include any service fees the guests pay the platform – just fees you pay);
    - supplies used solely by your paying guests (for example, if you provide them with a welcome basket of breakfast food or chocolates);
    - cleaning costs for the rental periods;
    - any additional property or contents insurance premium you pay (over what you would otherwise pay) because the property is used for short-stay accommodation; and
    - any additional rates you pay (over what the normal residential rates would be) because the property is used for short-stay accommodation.[3]

2 For a list of deductible and non-deductible rental property expenses, go to www.ird.govt.nz and search "rental property expenses".

3 Some councils may impose targeted rates in respect of properties used for short-stay accommodation.

22. You may have some expenses that you can split between being related solely to your rental activity and being mixed rental and private expenses. For example, expenses that have a fixed component and a usage component, like power. Mixed expenses usually need to be apportioned. However, if you can identify actual usage charges for a period where the dwelling was only rented out and not used privately at all, you do not have to apportion the usage component for that period – it is fully deductible. You might want to do this, for example, if there is a period where the usage component of an expense is higher than usual. For example, you rent your dwelling for three consecutive weeks during the winter and there is higher than usual power usage during those weeks as the guests use additional heating and appliances like the drier. However, the fixed charge component must be apportioned, as it is necessary to maintain a power connection, which is used both privately and by paying guests. While this approach might result in a larger deduction, it is not compulsory, and you may find it simpler to apportion the total expense for the year (both the fixed and usage components) between private use and income-earning use for the year.
23. While the starting point is that the above expenses may be fully deductible, if you rent the dwelling through an online marketplace, your deduction may need to be claimed on a GST-exclusive basis. This is discussed from [32].

Expenses that are non-deductible – relate solely to private use

24. Expenses that relate solely to the private use of the dwelling are not deductible (this includes use by you and by natural persons you are associated with but who are not charged rent). For example, if you use the dwelling for a month over the summer and you can identify actual usage charges that are a component of some of your expenses (for example, power), you cannot deduct any of the usage component for that period as it relates solely to your private use of the dwelling. Similarly, any consumables you use at the dwelling are not deductible. However, if you have consumables you use at the dwelling that are also available for guests to use (for example, tea, coffee, olive oil, shampoo, and soap), those consumables are partly deductible.

Expenses that are partly deductible – relate to both rental activity and private use

25. You can only claim deductions for **part of** any expenses that relate to both your rental activity and the private use of the dwelling. These mixed expenses might include:
    - interest on your loan for the property;[4]
    - repairs and maintenance;[5]
    - property and contents insurance premiums (excluding any additional premium imposed because the property is used for short-stay accommodation – as noted at [21], those amounts will be fully deductible);
    - rates (excluding any targeted rates imposed by councils because the property is used for short-stay accommodation – as noted at [21], those amounts will be fully deductible;
    - power bills (but see [22] and [24]); and
    - internet.
26. To work out what proportion of these mixed expenses you can claim, you need to consider:
    - the periods the property is rented out (including at "mates' rates") or available to be rented out; and
    - the periods the property is used privately (this includes use by family or friends who are not charged rent).
27. Generally, to work out the proportion of expenses you can deduct, you multiply those expenses by:

$$\frac{\text{nights the dwelling is rented out or available to be rented out}}{\text{nights in the year}}$$

4 From 1 April 2024, up to 80% of the interest can be claimed, and from 1 April 2025 up to 100% of the interest can be claimed. The actual amount claimed needs to be apportioned to account for any private use and any periods the property is not available to be rented out.

5 Deductible repairs and maintenance expenditure does not include expenditure on capital improvements (see **IS 12/03: Income tax – Deductibility of repairs and maintenance expenditure – general principles**).

28. You need to keep track of the number of nights you rent out the dwelling, and you need to have evidence of when it was available to be rented out. This evidence needs to be more than a mere statement of its availability, sporadic or limited advertising, or advertising that isn't likely to attract many customers. You need to have evidence of active and regular marketing of the dwelling at market rates, and that it's available at times and for periods that demonstrate it is genuinely available to rent.

29. Nights the dwelling is used privately are not counted as nights it is available to be rented out. This is the case even if the property remains advertised (for example, if you do not mark it as "unavailable" or "blocked" in an online booking system). Private use includes when you use the dwelling, and also when family or friends use it if they are not charged rent (even if they make a minor contribution to your expenses, as noted at [9]). In some situations, there may be an element of private use when a dwelling is vacant but available for rent. This might occur, for example, where a person uses the dwelling as a second home. In these circumstances, apportionment would be required for those periods (see **IS 23/10**: **Deductibility of holding costs for land** from [94]).

30. If guests have access to the whole dwelling (that is, there are no parts they are not permitted to use), your apportionment is based on the number of nights the dwelling is rented out or available to be rented out, as a proportion of the total nights in the year. Example | Tauira 1 explains how to apportion expenses where guests have access to the entire dwelling.

Example | Tauira 1 – Apportioning expenses where guests have access to the entire dwelling

Nathan and Joel have a holiday house in Queenstown that they and their extended family use for a total of 100 nights during the 2025-2026 income year. Their extended family do not pay rent. The house is rented out through their website (which is not an online marketplace) for 240 nights during the year and is advertised and available to be rented out throughout the year except when the family use it (so, 25 nights). The holiday house is not in the mixed-use asset rules, as it is not unused for 62 days or more during the year.

Nathan and Joel can deduct 100% of their expenses that relate solely to the rental activity. These expenses include the cost of advertising the house for rent, their host service fees, the additional rates they pay (over what the normal residential rates would be) because they rent the property out, and the additional insurance premium they pay (over what they would otherwise pay) because they rent the property out.

The house is rented out or available to be rented out for 265 out of the 365 nights of the year, so Nathan and Joel calculate that they can deduct 72.60% of their mixed expenses:

$$\frac{265}{365} \times 100 = 72.60\%$$

These mixed expenses include the interest on Nathan and Joel's loan for the property, utility bills, repairs and maintenance costs, the amount of their rates that equates to what the standard residential rates would be if the property was not in a higher rating category, and the amount of their insurance premium that equates to what their premium would be if the property was not rented out.

31. If part of the dwelling is not available for use by guests (for example, a locked room where you store your personal possessions), you cannot deduct the proportion of mixed expenses that relate to that space. You need to factor in the floor area calculations. Example | Tauira 2 explains how to do this.

Example | Tauira 2 – Apportioning expenses where part of the dwelling is not available to guests

Nathan and Joel from Example | Tauira 1 keep items they and their family use on holiday in one of the bedrooms in the house, which is locked, and cannot be used by guests. The bedroom is $25m^2$, and the whole house is $200m^2$.

Nathan and Joel calculate that they can deduct 63.53% of their mixed expenses:

$$\frac{175}{200} \times \frac{265}{365} \times 100 = 63.53\%$$

Are my expenses deducted on a GST-inclusive or GST-exclusive basis?

32. If you are GST-registered, you deduct your expenses on a **GST-exclusive basis**.

33. If you are not GST-registered and have opted to treat the flat-rate credit as assessable income, you deduct your expenses on a **GST-inclusive basis** (s DB 2).

34. If you are not GST-registered and have opted to treat the flat-rate credit as excluded income:
    - Expenses that relate to nights when the dwelling was rented through an online marketplace are deducted on a **GST-exclusive** basis. This is because the flat-rate credit you receive from the online marketplace is intended to recognise the GST on the expenses you incur when deriving this income, that you would be able to deduct as input tax in your GST return if you were GST-registered.
    - Expenses that relate to nights when the dwelling was rented out other than through an online marketplace, or was available to be rented out, are deducted on a **GST-inclusive** basis.

    (Section DB 2).

35. If you are not GST-registered and have opted to treat the flat-rate credit as excluded income, you may need to apportion your expenses. If you have expenses that relate to both nights when the dwelling was rented out through an online marketplace and nights when the dwelling was rented out other than through an online marketplace or was available to be rented out, these expenses need to be apportioned. Example | Tauira 3 explains how to do this.

Example | Tauira 3 – Apportioning expenses where a person is not GST-registered and has opted to treat the flat-rate credit as excluded income, and their dwelling is rented both through an online marketplace and in some other way

The facts are the same as in Example | Tauira 1, with the exceptions noted below.

Of the 240 nights that the house was rented out, 100 of those nights were rented out through an online marketplace and the remaining 140 nights were rented out through Nathan and Joel's website (which is not an online marketplace). The house is available for rent but not rented out for 25 nights.

This is summarised in the table below:

Use	Number of nights
Private use	100
Rented through online marketplace	100
Rented through website or available to be rented	165

Because the house is rented out or available to be rented out for 265 out of the 365 nights of the year, Nathan and Joel can potentially deduct 72.60% of their mixed expenses:

$$\frac{265}{365} \times 100 = 72.60\%$$

However, because Nathan and Joel are not GST-registered and have opted to treat the flat-rate credit as excluded income, they need to deduct their expenses that relate to the online marketplace nights on a GST-exclusive basis. Their expenses that relate to non-online marketplace nights are deducted on a GST-inclusive basis. The table below sets out Nathan and Joel's expenses and how they should calculate the deductions they can claim:

Expense	Amount	Amount apportioned to income-earning	Deduction
Commission charged by online marketplace	$600 (incl. GST)	100% = $600 (incl. GST)	$600 ÷ 1.15[6] = **$521.74 (excl. GST)**
Interest on loan for the property	$10,000 (GST exempt)	72.60% (265/365) = $7,260	**$7,260**

6 Dividing the amount apportioned to income-earning by 1.15 gives you the GST-exclusive amount.

Expense	Amount	Amount apportioned to income-earning	Deduction
Repairs and maintenance and other mixed expenses such as rates and property insurance	$10,000 (incl. GST)	72.60% (265/365) = $7,260 (incl. GST)	*Online marketplace nights:* 100 nights (out of 265 nights for which deductions are allowed). 100/265 x $7,260 = $2,739 (incl GST) ÷ 1.15 = **$2,381.74** (excl. GST) deduction for online marketplace nights *Non-online marketplace nights:* 165 (out of 265 nights for which deductions are allowed). 165/265 x $7,260 = **$4,520.37** (incl. GST) deduction for non-online marketplace nights *Total deduction for repairs and maintenance:* $2,381.74 + $4,520.37 = **$6,902.11**

Online marketplace commission: Nathan and Joel do not need to apportion the commission charged by the online marketplace as it relates only to the rental activity. But their deduction must be claimed on a GST-exclusive basis. The $600 commission charged is divided by 1.15 to give a GST-exclusive deduction of **$521.74**.

Interest on loan for the property: From the 2025-2026 income year, Nathan and Joel can claim up to 100% of the interest on their property loan. However, this interest needs to be apportioned between private use and income-earning use. As discussed in this QWBA, under the standard income tax rules this is done based on the amount time the asset is used for income-earning or available for income-earning during the income year. For the income year, there are 265 nights the property is used or available for income-earning nights. Therefore, Nathan and Joel can deduct 72.60%, (265/365) of $10,000 which is **$7,260.27**. GST is not applied to interest, so there is no need for any further calculations for the online marketplace nights.

Repairs and maintenance and other mixed expenses: On the same basis as for interest, 72.60% of the $10,000 expense for repairs and maintenance, is attributable to income-earning. This is $7,260.27 (incl. GST).

The proportion of the expenses attributable to income-earning that relates to online marketplace nights is 37.73% (as 100 out of the 265 nights the dwelling is used or available for income-earning are online marketplace nights), so $2,739.73 (incl. GST). This amount is then divided by 1.15 to give a GST-exclusive amount of $2,382.37.

The proportion of the expenses attributable to income-earning that relates to non-online marketplace nights, which includes available to rent nights, (62.26%) is $4,520.55 (incl. GST).

Therefore, the total amount of the repairs and maintenance and other mixed expenses deduction is **$6,902.92** ($2,382.37 + $4,520.55).

Nathan and Joel's total deduction in relation to the rental activity is therefore **<u>$14,684.93</u>** ($521.74 + $7,260.27 + $6,902.92).

If Nathan and Joel had opted to treat the flat-rate credit as assessable income, they would not need to undertake any apportionment – all their expenses would be deductible on a GST-inclusive basis.

Depreciation of chattels

36. As noted at [18], you can also claim deductions for the depreciation of the chattels in the dwelling that paying guests can use. Depreciation deductions reflect that chattels in the dwelling are subject to wear and tear, resulting in a reduction in their value while being used to earn income.
37. As with mixed expenses, you can only claim for part of the depreciation because the chattels are used when the dwelling is rented out to earn income and also when it is used privately.

38. The approach to working out how much depreciation you can claim each year is similar to the approach for apportioning mixed expenses. But it does differ slightly, as there is a specific apportionment formula in the Income Tax Act 2007 for depreciation of assets partly used to earn income.

39. Before you can apply the formula, you need to work out the depreciation loss for the income year for each asset.

40. For low value items ($1,000 or less),[7] the depreciation loss is the item's cost. If the item is part of a group of items you purchased at the same time from the same supplier, and the items would have the same depreciation rate, the $1,000 threshold applies to the group of items. For example, if you bought $2,000 worth of linen at one time, you would have to depreciate the linen using one of the methods mentioned at [41].

41. For other items, you work out the depreciation loss for the income year using either the diminishing value method or the straight-line method. There is information about those methods on Inland Revenue's website (go to **www.ird.govt.nz** and search "claiming depreciation"), and you can find the relevant depreciation rates using Inland Revenue's **depreciation rate finder and calculator** – also available on Inland Revenue's website.

42. Whichever method you use, you cannot pool assets to depreciate them as a single asset if they are partly used privately – so you will not be able to use the pooled approach for the chattels in the dwelling.

43. Once you know the depreciation losses for the year for the chattels in the dwelling that paying guests can use, you need to work out what proportion of those losses you may deduct. To do this, multiply those losses by:

$$\frac{\text{nights the dwelling is rented out or available to be rented out}}{\text{nights in the year the dwelling is used or available for any purpose}}$$

44. While it is the chattel depreciation that is being worked out, the chattels are only used or available for use when the dwelling is – which is why the dwelling rental and availability nights are used to calculate the allowable chattel depreciation loss.

45. The difference between this formula and the approach for mixed expenses is that you are identifying the number of nights the dwelling is rented out or available to be rented out as a proportion of all the nights in the year it is available for any purpose, rather than as a proportion of all of the nights in the year. So, if the dwelling is not available for use by anyone for a period, those nights are not counted. Example | Tauira 4 illustrates this situation.

Example | Tauira 4 – Depreciation of chattels where the chattels are also used privately

Nicola has a holiday home in a popular tourist town. Nicola and her friends used it for a total of 80 nights during the year, and it was rented out for 230 nights. The house was uninhabitable for 52 days during the year, while Nicola had the house extended by building a loft bedroom and deck with lake views. The house was advertised and available to be rented out throughout the year, except when booked out for Nicola and her friends to use, and over the building period. The holiday home is not in the mixed-use asset rules, as it is not unused for 62 days or more during the year.

Nicola calculates that she can deduct 63.84% of her mixed expenses (property loan interest, insurance, rates, power bills and internet):

$$\frac{233}{365} \times 100 = 63.84\%$$

However, for depreciation the calculation is slightly different. Instead of dividing the rental and available for rental days by the number of days in the year, the total of those days is divided by the number of days the property is used or available for any purpose, which would exclude the 52 building days when it could not be used. Nicola calculates that she can deduct 74.44% of her depreciation losses for the chattels in the house:

$$\frac{233}{313} \times 100 = 74.44\%$$

7 For items acquired on or after 17 March 2021.

46. If you are GST-registered, you calculate depreciation on the **GST-exclusive** price of the asset. If you are not registered for GST, you claim depreciation on the **GST-inclusive** price of the asset. This is the position, even if you rent your dwelling through an online marketplace.

The residential rental ring-fencing rules

47. The residential rental ring-fencing rules mean you can only claim deductions for expenses incurred on the property up to the amount of income you earned from the property in the income year.[8] If your allowable deductions exceed the income from the property,[9] the excess deductions must be carried forward to future income years. You cannot offset the excess amount against other income, such as salary or wages.

48. There is more information about the residential rental ring-fencing rules in the Appendix to **IS 23/04**: **The interest limitation rules and short-stay accommodation** (from A48).

Who must declare the income?

49. The rental income belongs to the owner of the land (including leasehold land) and they must declare it to Inland Revenue. If there is more than one owner, the income needs to be split appropriately between them.

50. If the dwelling is owned in a trust, the rules about who must declare the income are more complicated. You should refer to **QB 25/05**: **If property held in a trust is rented out for short-stay accommodation, who should declare the income, and what deductions can be claimed?** for more detailed guidance.

51. If you lease the property and use it to earn income, you should ensure you are paying an adequate rent for the property to the extent you use the property for the income-earning. If you do not, in certain circumstances the Commissioner can determine an amount of adequate rent and you will be treated as deriving this amount as rental income (s GC 5). This rule ensures that property cannot be leased between (for example) relatives or different entities for low or nominal rent to shift income for a tax benefit.

What records do I need to keep?

52. Because the dwelling may or may not fall within the mixed-use asset rules (remember, you need to work out each year whether it does), you need to keep good records so you can apply the income tax rules correctly. This includes records of:
    - the number of nights you rent out the dwelling at market value, and how much income you receive;
    - the number of nights you rent out the dwelling at "mates' rates", and how much income you receive;
    - the number of nights you, or people you are associated with, used the dwelling;
    - when the dwelling was available to be rented out (see [28] and [29]);
    - any expenses you may claim deductions for; and
    - any ring-fenced expenditure you have in respect of the dwelling.

Provisional tax

53. If the residual income tax you have to pay at the end of the year, after you have filed your tax return, is more than $5,000, you will have to pay provisional tax the following year. This means you will pay your income tax in instalments during the year. The Inland Revenue website has further information about **provisional tax**.

8 Or, if the property is part of a portfolio of residential rental properties you own, you can only claim deductions for expenses incurred on the portfolio of properties up to the amount of income you earned from the portfolio in the income year.

9 Or portfolio of properties, if you have one.

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QB 25/05: Income tax – If property held in a trust is rented out for short-stay accommodation, who declares the income and what deductions can be claimed?

Issued | Tukuna: 3 April 2025

This question we've been asked (QWBA) explains how the income tax rules apply if property held in a trust is rented out as short-stay accommodation (for example, through Airbnb, Bookabach, Booking.com or Holiday Houses).

REPLACES | WHAKAKAPIA:

- **QB 19/15:** If property held in a trust is rented out by a beneficiary of the trust for short-stay accommodation, who should declare the income, and what deductions can be claimed?
- **QB 19/16:** If property held in a trust is rented out by the trustees for short-stay accommodation, who should declare the income, and what deductions can be claimed?

Key provisions | Whakaratonga tāpua

Income Tax Act 2007 – ss CC 1, CG 4, CH 5B, DA 1, DB 2, DV 9, subpart EE, subpart EL, YB 4, YB 11, and YA 1

Tax Administration Act 1994 – s 43B

Question | Pātai

If property held in a discretionary trust is rented out for short-stay accommodation, who declares the income, and what deductions can be claimed?

Answer | Whakautu

The answer depends on who rents out the property – the trustees or a beneficiary.

Income

If the trustees rent out the property for short-stay accommodation (for example, a holiday home or a dedicated short-stay accommodation property), the income belongs to the trustees, and it will generally have to be declared in the trust's tax return and taxed at the trust tax rate. However, if some or all of the income is allocated as beneficiary income, the income belongs to the beneficiary and it will generally have to be declared in the beneficiary's tax return and taxed at the beneficiary's tax rate.

If a beneficiary rents out all or part of the property for short-stay accommodation (for example, the property is the beneficiary's home and they rent out a room), the income belongs to the beneficiary as they grant the licence to the guests to stay. The income will generally have to be declared in the beneficiary's tax return and will be taxed at the beneficiary's tax rate.

Deductions

Non-capital expenses related to earning the income are deductible. However, these expenses will only be partly deductible where they also relate to private use or non income-earning use of the property.[1]

Some or all deductions may need to be claimed on a GST-exclusive basis, depending on whether the person renting out the property is GST-registered and whether the property is rented out through an online marketplace. This is discussed in more detail from [85].

If the rental activity is loss-making, the person renting out the property may be unable to claim all their deductible expenses in that income year. Some deductions might have to be carried forward to future income years.

1 For a list of deductible and non-deductible rental property expenses, go to www.ird.govt.nz and search "rental property expenses".

Key terms | Kīanga tau tāpua

Guest means a person provided with short-stay accommodation in return for payment.

Online marketplace means an electronic platform like a website, app or internet portal that sellers use to market and sell their short-stay accommodation. It does not include an online marketplace that only processes payments.

Renting out and similar terms are used in this QWBA to refer to granting a licence to short-stay accommodation guests for use of the property.

Short-stay accommodation means accommodation provided for up to four consecutive weeks in a dwelling that is not the guest's ordinary residence. It does not include accommodation provided to residential tenants, boarders or care home residents, and it does not include student or emergency accommodation.

Trust is sometimes used in this QWBA to mean the trustees of the trust, for simplicity.

Explanation | Whakamāramatanga

Who rents out the property?

1. Rental income from land belongs to the owner of the land and they must declare it to Inland Revenue.
2. Owning land is not limited to having the legal title. Under the Income Tax Act 2007 (the Act), someone will own land if they have an estate or interest in land. This could be freehold, leasehold, or any other interest in land.
3. Beneficiaries of a discretionary trust do not have an interest in the trust property simply because they are beneficiaries. In many situations where a property is held in a trust, it will be only the trustees, who legally own the land, who have an interest in the land. This will generally be the case for a dedicated short-stay accommodation property, or for a holiday home that is also sometimes rented out to third parties. Where only the trustees have an interest in the land, it will be the trustees renting out the property, and the rental income will belong to the trustees.
4. However, in some situations there will be other people with interests relating to the same underlying piece of land, and they will also be owners of land for income tax purposes. In these situations, where the property is rented out, the rental income will belong to the person whose interest in land is affected.
5. For example, if a beneficiary of a trust has a right to possession of the property, or if they in fact occupy it, they have an interest in land as defined in the Act. A right to possession of land is specifically defined as an "interest in land" (s YA 1). Even if a beneficiary did not have the right to possession of the property, if they occupy the property, there is a "tenancy at will",[2] which gives rise to an interest in land.[3] The most common situation where a beneficiary will have an interest in the land is where the property is the beneficiary's family home.
6. Where a beneficiary has an interest in the land and they rent the property out to short-stay accommodation guests, it is their interest that is affected. It is their right to possession of the property, or their interest as tenant at will, that is affected by the property being rented out, not the trustees' legal interest in the land. Therefore, if a beneficiary has an interest in the land and rents out all or part of the property for short-stay accommodation, the income belongs to them.

This QWBA is in two parts:

- **PART 1**: explains who must declare the income to Inland Revenue and what deductions can be claimed if the person renting out the property for short-stay accommodation is **a trustee** (from [7]).
- **PART 2**: explains who must declare the income to Inland Revenue and what deductions can be claimed if the person renting out the property for short-stay accommodation is **a beneficiary** (from [49]).

2 DW McMorland and others, *Hinde, McMorland and Sim, Land Law in New Zealand* (online ed, LexisNexis), at [11.022], and *Laws of New Zealand* Lessor and Lessee (online ed, accessed 14 February 2025) at [108] – [112]).

3 DW McMorland and others, *Hinde, McMorland and Sim, Land Law in New Zealand* (online ed, LexisNexis) at [10.010(c)].

Part 1: The trustees rent out the property

7. This part of the QWBA considers the situation where the trustees of the trust rent out the property for short-stay accommodation.

8. The most common situations where trustees of a trust rent out property held in a trust for short-stay accommodation are where the property is:
   - a dedicated short-stay accommodation property; or
   - a family holiday home that is sometimes rented out.

Summary – income tax implications if the trustees rent out the property

9. Table | Tūtohi 1 summarises the income tax implications for short-stay accommodation properties held in a trust, where the rental income is derived by the trustees.

Table | Tūtohi 1 – Summary – income tax implications if the trustees rent out the property

Item	Explanation
Income	Generally, all amounts received from paying guests are **income to the trustees**. However, if the property is subject to the mixed-use asset rules (the MUA rules) – see from [14], the following amounts are **exempt income**: • Amounts received for renting the property to associated natural persons (for example, settlors and beneficiaries). • Amounts received from renting the property at "mates' rates" (less than 80% of the market value rent).
Expenses incurred by and paid by the trustees	Expenses incurred by and paid by the trustees: • are **deductible to the trustees**, but • must be apportioned (so will be only partly deductible) if the property is also used for non income-earning purposes; and • the deduction may need to be claimed on a GST-exclusive basis (see from [85]). See from [24] for how to apportion expenses for property subject to the MUA rules, or from [31] for property not subject to the MUA rules.
Expenses incurred by the trustees and paid by a beneficiary	**For the beneficiary** These expenses are **not deductible to the beneficiary**, as there is no connection between the expenses and the beneficiary earning income. **For the trustees** These expenses: • are **deductible to the trustees**; but • must be apportioned (so will be only partly deductible) if the property is also used for non income-earning purposes; and • the deduction may need to be claimed on a GST-exclusive basis (see from [85]). If the trustees **do not reimburse** the beneficiary, the amount of the expenses paid by the beneficiary is **income to the trustees** as either: • **rental income under s CC 1**, if paid by the beneficiary for their use of and/or ability to use the property, (provided the property is not subject to the MUA rules); or • **income under s CG 4**, to the extent of the deduction the trustees have been allowed, if not paid by the beneficiary for their use of and/or ability to use the property, or if the property is subject to the MUA rules.

Expenses incurred by a beneficiary	If the trustees reimburse the beneficiary for expenses the beneficiary has incurred (by actual payment or through their beneficiary current account), the reimbursement: • is **deductible to the trustees**; but • must be apportioned (so will be only partly deductible) if the property is also used for non income-earning purposes; and • the deduction may need to be claimed on a GST-exclusive basis (see from [85]). If the trustees **do not reimburse** the beneficiary, the expenses cannot be deducted by anyone. If the trustees do not reimburse the beneficiary, the amount of the expense incurred by the beneficiary could be: • **Rental income of the trustees**, but only if the property is not subject to the MUA rules, and the beneficiary incurred the expense for their use of and/or ability to use the property. • **A settlement on the trust or a distribution from the trust to the beneficiary**. This will depend on the value of what the beneficiary and the trust are providing to each other under the arrangement. This includes the value of expenses incurred by the beneficiary that are of value to the trust and the market value of any use of and/or the ability to use the property the beneficiary gets in return for incurring those expenses.

Which tax rules apply?

10. If the property is sometimes rented out and sometimes used by people associated with the trust (for example, a holiday home that is sometimes rented out to beneficiaries), the first step is to work out which rules apply to the property for the income year:
    - the mixed-use asset rules (the MUA rules); or
    - the standard tax rules.
11. **QB 25/02: Income tax – Which rules apply if I have a dwelling I sometimes rent out as short-stay accommodation and also sometimes use privately?** explains how to work out which rules apply. You need to revisit which rules apply each income year (for most people this is 1 April – 31 March).[4]
12. The property will be a mixed-use asset if, during the income year it was:
    - used it to earn income;
    - used privately (this includes use by family members, or by friends renting it for "mates' rates" that are less than 80% of the market value rent); and
    - not used for at least 62 days in the year.
13. If the property is a mixed-use asset, there are some situations where the taxpayer can choose to opt out of the tax rules. This is explained in QB 25/02.

The rental income is derived by the trustees

14. If the trustees rent out the short-stay accommodation, the rental income belongs to the trustees.
15. Generally, all amounts the trustees receive from paying guests will be rental income. However, this does not include minor contributions from family or friends who are not charged rent (for example, if they pay $20 towards their power usage).
16. In addition, if the MUA rules apply, the following amounts will be exempt income:
    - amounts received for renting the property to associated natural persons (for example, a settlor or beneficiary of the trust); and
    - amounts received from renting the property at "mates' rates" (less than 80% of the market value rent).
17. What amounts are taxable income or exempt income under the MUA rules is discussed in detail in **QB 25/03**: **Income tax - How do the mixed-use asset rules apply if I provide short-stay accommodation?**

4 Guidance on moving between the standard tax rules and the mixed-use asset rules can be found in **IS 25/08: Income tax – implications of a residential property moving between the standard tax rules and the mixed-used asset rules.**

Expenses incurred by the trustees are deductible to them

18. Because the rental income belongs to the trustees, non-capital property-related expenses incurred by the trustees will be deductible to them under s DA 1, subject to any apportionment required.[5] This is the case regardless of whether the expenses are paid by the trustees or by a beneficiary. These expenses might include:
    - interest on the loan for the property;[6]
    - repairs and maintenance;[7]
    - property and contents insurance premiums (including any additional premiums imposed because the property is used for short-stay accommodation);
    - rates (including any targeted rates imposed by councils because the property is used for short-stay accommodation);[8]
    - utility bills;
    - advertising costs, including any commissions or fees the trustees pay to an advertising platform or transaction facilitator (this does not include any service fees the guests pay the platform, just fees the trustees pay).
19. Expenses are incurred by the trustees if they either paid or became definitively committed to the expenses in the income year. This includes the following:
    - Where the trustees have incurred the obligation themselves (for example, rates and property insurance).
    - Where the trustees have agreed they will reimburse a beneficiary for expenses incurred by the beneficiary. For example, if a beneficiary gets the power, pay-TV or internet connected in their name (which is often the case, as it is easier than getting those services connected in the trustees' names). In those situations, the agreement to reimburse the beneficiary is an obligation incurred by the trustees. Example | Tauira 1 illustrates this scenario.
20. It may be that a beneficiary of the trust is also a trustee and connects services such as power or internet in their individual name. Generally, the person would be incurring the expenses in their capacity as trustee, so the expenses would be incurred directly by the trustees.
21. Some or all of the rental income may be allocated as beneficiary income, which means it is taxed at the beneficiary's tax rate rather than at the trust rate. However, for the purpose of determining the deductions the trust is allowed, the beneficiary income is treated as trustee income (s DV 9(2)). This means all the non-capital expenses the trust incurs in relation to the rental activity will be deductible to the trustees, subject to any apportionment required.

Dedicated short-stay accommodation property

22. If the property is a dedicated short-stay accommodation property, non-capital property-related expenses will be fully deductible and no apportionment is necessary. Depreciation losses on the property's chattels would also be fully deductible. Example | Tauira 1 concerns a dedicated short-stay accommodation property.

Example | Tauira 1 – A dedicated short-stay accommodation property

The B-F Family Trust is GST-registered and owns an investment property in Queenstown that is rented out on Airbnb. The property is not used at all by the settlors (who are deceased) or by beneficiaries of the trust. It is therefore a dedicated short-stay accommodation property.

The corporate trustee pays all the property-related expenses from its bank account. This includes the power, internet, and pay-TV bills. The connections for those services are in the names of Ani and Charlie, who are beneficiaries (but not trustees) of the trust. The connections were signed up for in Ani and Charlie's names as this was easier. But there is an agreement that the trustee will pay all those expenses.

All the rental income is income to the trustee. All the non-capital property-related expenses are deductible to the trustee, on a GST-exclusive basis. This includes the power, internet and pay-TV bills, as the trustee pays those. Because the property is only used for rental purposes, the expenses are all fully deductible.

5 For a list of deductible and non-deductible rental property expenses, go to www.ird.govt.nz and search "rental property expenses".

6 From 1 April 2024, up to 80% of the interest on the loan can be claimed, and from 1 April 2025 up to 100% of the interest can be claimed.

7 Deductible repairs and maintenance expenditure does not include expenditure on capital improvements (see **IS 12/03: Income tax – Deductibility of repairs and maintenance expenditure – general principles**).

8 Some councils may impose targeted rates in respect of properties used for short-stay accommodation.

A holiday home that is sometimes rented out

23. If the property is sometimes rented out and sometimes used by people associated with the trust (for example, a family holiday home that's sometimes rented out to beneficiaries of the trust), the proportion of the expenses that can be deducted will depend on whether the MUA rules or the standard tax rules apply (see from [10]).

If the MUA rules apply to the holiday home

24. If the MUA rules apply to the holiday home, the starting point is that expenses that relate solely to the rental activity (for example, advertising fees) are fully deductible. However, the deduction may need to be claimed on a GST-exclusive basis, depending on whether the trust is GST registered and whether the property is rented out through an online marketplace (see from [85]).
25. Mixed expenses – those that relate to both the rental activity and the private use of the property – must be apportioned. Mixed expenses include things like rates, insurance, utility bills, and property loan interest. Again, these deductions may need to be claimed on a GST-exclusive basis.
26. Use of the holiday home by natural persons who are associated with the trustees counts as private use for the apportionment formula in the MUA rules. Use by anyone else for less than 80% market value rent (for example, friends staying and paying "mates' rates") will also be private use.
27. Persons associated with the trustees include:
    - beneficiaries of the trust;
    - settlors of the trust;
    - persons associated with beneficiaries of the trust under the "two relatives" test[9] (s YB 4); and
    - persons with a power of appointment or removal of trustees – unless within the exclusion for providers of professional services (s YB 11(2)).
28. A guide to associated persons definitions for income tax purposes – **IR620** explains how to work out if someone is associated with the trustees.
29. QB 25/03 explains how to calculate the percentage of the mixed expenses that is deductible under the MUA rules. The same formula is generally used to calculate the portion of deductible depreciation losses for the property's chattels. However, depreciation losses or depreciation recovery income on disposal, is calculated under the depreciation provisions in subpart EE.
30. Example | Tauira 2 explains how the MUA rules apply to a holiday house.

Example | Tauira 2 – Where the MUA rules apply to a holiday house

The Fab Five Family Trust is GST-registered and owns the Brown family's holiday home. The Browns use the holiday home for 45 nights during the income year. The trustees of the Fab Five Family Trust rent it out to friends of the Browns for 15 nights in the year for "mates' rates" of $50 a night, and the trustees rent it out to unrelated third parties for 80 nights in the year for $200 a night.

The trustees have used QB 25/02 to work out the holiday house is a mixed-use asset for the income year because it was:

- used privately (by the Browns, who are beneficiaries and settlors of the trust, and by friends for less than 80% of the market value rent);
- used to earn income; and
- vacant for 62 days or more in the income year.

Therefore, the MUA rules apply.

9 Essentially, two people are associated if they are within two degrees of blood relationship, married, in a civil union or *de facto* relationship, or one person is within two degrees of blood relationship to the other person's spouse, civil union partner or *de facto* partner.

The trustees pay most of the property-related expenses from their bank account. This includes the power and internet bills, even though the connections for those services are in the name of Mrs Brown, who is a settlor and beneficiary of the trust. The connections were signed up for in Mrs Brown's name as this was easier, but there is an agreement that the trustees will pay those expenses. However, Mr and Mrs Brown have a loan (in their names, with a guarantee provided to the bank by the trustees) from when they bought the property and settled it on the trust, and they pay the loan repayments. The trustees reimburse Mr and Mrs Brown for the interest component of the loan repayments. This is recorded in Mr and Mrs Brown's beneficiary current accounts.

The rental income from the full-rate paying guests is income to the trustees. The $50 a night "mates' rates" paid by the Browns' friends is not income to the trustees – it is exempt income because it is less than 80% of the market value rent.

Some of the trustees' expenses are fully deductible. This includes the fees they pay to Airbnb and Bookabach, and the cost of cleaners who come in after the full-rate paying guests.

Other expenses the trustees incur need to be apportioned under the formula in the MUA rules, as they relate to both the rental activity and the private use of the holiday home (by the Browns and their friends who pay less than 80% of market value rent). These expenses include the power and internet bills, as the trustees pay those, and the loan interest the trustees reimburse Mr and Mrs Brown for. The trustees use QB 25/03 to work out the deductible portion of these mixed expenses.

As the Trust is GST-registered, all expenses are deducted on a GST-exclusive basis.

Note: There may be a settlement on the trust or a distribution from the trust. This depends on the value of what Mr and Mrs Brown and the trust are providing each other under the arrangement.

If the standard tax rules apply to the holiday home

31. If the standard tax rules apply to the holiday home, the starting point is that expenses that relate solely to the rental activity (for example, advertising fees) are fully deductible. However, the deduction may need to be claimed on a GST-exclusive basis, depending on whether the trust is GST registered and whether the property is rented out through an online marketplace (see from [85]).
32. Mixed expenses – those that relate to both the rental activity and non income-earning use of the property (for example, use by beneficiaries or settlors of the trust) – must be apportioned. Mixed expenses include things like rates, insurance, utility bills, and property loan interest. Again, these deductions may need to be claimed on a GST-exclusive basis.
33. **QB 25/04**: **Income tax – How do the standard tax rules apply if I provide short-stay accommodation** explains how to calculate the percentage of mixed expenses that is deductible under the standard tax rules. Although QB 25/04 refers to expenses not being deductible for private use (which a trust cannot have), the same approach can be used. This is because there will only be the required nexus between the expenses and income-earning to the extent the property is rented out or available to be rented out.
34. Depreciation losses on the property's chattels will also be partly deductible. QB 25/04 explains how to calculate the percentage of depreciation losses that is deductible.

35. Example | Tauira 3 explains how the standard tax rules apply to a holiday house.

Example | Tauira 3 – Where the standard tax rules apply to a holiday house

The We Are Family Trust owns the Miller family's holiday house in a popular tourist destination. The Millers use the holiday house for 90 nights during the income year and rent it out as short-stay accommodation for 220 nights in the income year.

The trustees have used QB 25/02 to work out the holiday house is not subject to the MUA rules for the income year, so the standard rules apply. This is because the holiday house was not vacant for 62 days or more during the income year.

Short-stay accommodation guests pay rental income into the trustees' bank account, and the trustees pay most of the property-related expenses from their bank account. This includes the power, pay-TV and internet bills, even though the connections for those services are in the name of Mr Miller, who is a settlor and beneficiary of the trust. The connections were signed up for in Mr Miller's name as this was easier, but there is an agreement that the trustees will pay those expenses. However, Mr and Mrs Miller have a loan (in their names) from when they bought the property and settled it on the trust, and they pay the loan repayments. The trustees reimburse Mr and Mrs Miller for the interest component of the loan repayments. This is recorded in Mr and Mrs Miller's beneficiary current accounts.

The rental income from the short-stay accommodation guests is income to the trustees.

Some of the trustees' expenses are fully deductible. This includes the fees they pay to the Holiday Houses and Bookabach websites, which they advertise on, and the cost of cleaners who come in after the paying guests' stays.

Other expenses the trustees incur need to be apportioned, as they relate to both the rental activity and the non income-earning use of the holiday home (when it is used by the Millers). These expenses include the power and internet bills, as the trustees pay those, and the loan interest the trustees reimburse Mr and Mrs Miller for. The trustees use QB 25/04 to help them work out the deductible portion of these expenses.

As the Trust is GST-registered, all expenses are deductible on a GST-exclusive basis.

Note: There may be a settlement on the trust or a distribution from the trust. This depends on the value of what Mr and Mrs Miller and the trust are providing each other under the arrangement.

Beneficiary not reimbursed for paying an expense incurred by the trustees

36. For properties that are either dedicated short-stay accommodation properties or holiday homes that are sometimes rented out, the trust will likely have a bank account that guests pay rental income into. Therefore, where the trustees have incurred an obligation themselves (for example, rates and property insurance), they will likely have the funds to pay the expense. But if the trustees do not have the funds to pay the expense, or for some other reason a beneficiary pays it instead, the expense would still be deductible to the trustees as they have incurred the legal obligation.

37. However, if the trustees do not reimburse the beneficiary (either directly or through the beneficiary's current account), the amount of the expense paid by the beneficiary will be income to the trustees either:

- under s CC 1, if:
  - the amount is paid by the beneficiary for their use of and/or ability to use the property; and
  - the property is not subject to the MUA rules; or
- under s CG 4, to the extent of the deduction the trustees have been allowed.

Expenses incurred by a beneficiary and reimbursed by the trustees

38. A beneficiary (who is not also a trustee) may incur an obligation to pay some property-related expenses (such as power or internet bills), because it is easier to have those services connected in an individual's name.

39. Those expenses are not deductible to the beneficiary, as there is no nexus between the expenses and the beneficiary earning income. The income from the rental activity belongs to the trustees.

40. However, there may be agreement that the trustees will reimburse the beneficiary for these expenses. If this is the case, the agreement to reimburse the beneficiary is an obligation incurred by the trustees. The trustees can therefore deduct the amount they reimburse the beneficiary (whether directly or through the beneficiary's current account), subject to any apportionment required (see from [23]).

Expenses incurred by a beneficiary and not reimbursed by the trustees

41. If a beneficiary has incurred a property-related expense that the trustees do not reimburse them for, the expense cannot be deducted by anyone.
42. The amount could be rental income of the trustees, but only if the property is not subject to the MUA rules, and the beneficiary incurred the expense for their use of and/or ability to use the property.
43. Otherwise, the amount could be a settlement on the trust or a distribution from the trust to the beneficiary. Whether there is a settlement or distribution and if so the amount of the settlement or distribution, will depend on the value of what the beneficiary and the trust are providing each other under the arrangement. This includes the value of property-related expenses incurred by the beneficiary that are of value to the trust and the market value of any use of and/or ability to use the property the beneficiary gets in return for incurring those expenses. These concepts are discussed in more detail **in IS 24/01**: **Taxation of trusts**.

Allocation of deductions if the rental activity is loss-making

44. If the MUA rules do not apply and the rental activity is loss-making, the residential rental ring-fencing rules in subpart EL may limit the deductions that can be allocated to the income year.
45. The residential rental ring-fencing rules mean trustees can only claim deductions for expenses incurred on the property up to the amount of income earned from the property in the income year.[10]
46. Any deductions that cannot be allocated to the income year because of the residential rental ring-fencing rules will be carried forward to the next income year the trustees derive residential income.
47. There is more information about the residential rental ring-fencing rules in the Appendix to **IS 23/04**: **The interest limitation rules and short-stay accommodation** (from A48).
48. If the MUA rules apply, there are separate rules called the mixed-use asset expenditure quarantine rules that may apply in this situation if the rental activity is loss-making – see QB 25/03.

Part 2: A beneficiary rents out the property

49. This part of the QWBA considers the situation where a beneficiary of the trust rents out the property for short-stay accommodation.
50. The most common situation where a beneficiary of a trust may rent out property held in a trust for short-stay accommodation is where the property is the beneficiary's home.

10 Or, if the property is part of a portfolio of residential rental properties owned by the trust, deductions for expenses incurred on the portfolio of properties can only be claimed up to the amount of income earned from the portfolio in the income year.

Summary – income tax implications if a beneficiary rents out the property

51. Table | Tūtohi 2 summarises the income tax implications for short-stay accommodation properties held in a trust, where the income is derived by a beneficiary of the trust.

Table | Tūtohi 2 - Summary – where the beneficiary rents out the property and the property is the beneficiary's home

Item	Explanation
Income	Generally, all amounts received from paying guests are **income to the beneficiary**. However, some amounts may be **exempt income**. This will be the case if: • **DET 19/02: Standard-cost household service for short-stay accommodation providers** (discussed from [53]) is used; or • the MUA rules apply (see from [54]).
Expenses incurred by the trustees and paid by a beneficiary **OR** **Expenses incurred by a beneficiary**	**For the beneficiary** If the beneficiary pays all the property-related outgoings, they may be eligible to use DET 19/02. This is a simplified method for meeting the tax obligations for the short-stay accommodation activity. If DET 19/02 is used: • The rental income the beneficiary gets from the property is **exempt income** up to the amount of the standard-costs. • Only income over the amount of the standard-costs needs to be declared. • The beneficiary **cannot deduct** any of their actual expenses, unless it is for something not covered by the standard-costs and they have assessable income from providing the short-stay accommodation (for example, their income from providing the short-stay accommodation exceeds their standard-costs). If DET 19/02 is not used, the expenses are **deductible to the beneficiary**, subject to: • apportionment for private use (see QB 25/01); and • the deduction needing to be claimed on a GST-exclusive basis (see from [85]). **For the trustees** The amount of any expenses incurred by the trustees and paid by the beneficiary is rental **income to the trustees**. This will be cancelled out by the expenditure being **deductible to the trustees** because it is incurred by them. If the trust is a non-active trust and has filed a Declaration for trusts and estates not required to file returns – IR633, the trustees do not need to file a return. Otherwise, the trustees do need to file a return and include the rental income and deductions.
Expenses incurred by and paid by trustees	Expenses incurred by and paid by trustees are **not deductible** to anyone, unless the beneficiary pays rent to the trustees (including through reimbursement of the expenses, for the right to use the property).

The beneficiary's income and deductions

Income

52. Generally, all amounts received from paying guests will be income, and for the reasons discussed at [1] to [6], the income is derived by the beneficiary.

53. The beneficiary may be eligible to use the simplified method in DET 19/02 for meeting their tax obligations from providing the short-stay accommodation (discussed from [58]). If they use this method, some or all of the income will be exempt, and it will only be necessary to return income over a certain level. This reflects the typical costs incurred in providing short-stay accommodation in your home.

54. If **DET 19/02** is not used and the MUA rules apply there may also be some exempt income. The MUA rules could apply, for example, if a separate dwelling on the same property as the beneficiary's home is rented out (for example, a sleepout), or if the home is vacant for 62 days or more in the year (for instance, if the beneficiary was away for an extended holiday and the home was unused during that time).

55. If the MUA rules apply, the following amounts will be exempt income:
    - amounts received for renting the property to associated natural persons (for example, close relatives of the beneficiary such as their children, grandchildren, siblings or in-laws); and
    - amounts received from renting the property at "mates' rates" (less than 80% of the market value rent).

56. What will be income or exempt income under the MUA rules is discussed in detail in QB 25/03.

Deductions

57. Often where a beneficiary's home is held in a trust the beneficiary will pay all the outgoings for the property, irrespective of who the expenses are legally incurred by (for example, rates, insurance, repairs and maintenance, and any loan repayments for the property).

58. Where the beneficiary's home is used to earn short-stay accommodation income (for example, through renting out a room or the whole property from time to time) and the beneficiary pays all of the property-related outgoings, they may be eligible to use standard-cost determination DET 19/02. This is a simplified method for a taxpayer to use to meet their tax obligations from providing short-stay accommodation in all or part of their home.

59. If DET 19/02 is used, income up to the amount of set standard-costs is exempt. Only income in excess of the standard-costs needs to be returned. No deductions for expenditure actually incurred are allowed, unless the expenditure is for things not covered by the standard-costs in the determination.

60. If DET 19/02 is not used, non-capital property-related expenses the beneficiary pays will be deductible to the beneficiary, subject to:
    - appropriate apportionment for any expenses that do not solely relate to the income-earning use of the property; and
    - the deduction needing to be claimed on a GST-exclusive basis (see from [85]).

61. These deductible expenses might include:
    - interest on the loan for the property;[11]
    - repairs and maintenance;[12]
    - property and contents insurance premiums (including any additional premium imposed because the property is used for short-stay accommodation);
    - rates (including any targeted rates imposed by councils because the property is used for short-stay accommodation);[13]
    - utility bills;
    - advertising costs, including any commissions or fees the beneficiary pays to an advertising platform or transaction facilitator (this does not include any service fees the guests pay the platform, just fees the beneficiary pays).

62. The starting point is that expenses that relate solely to the rental activity (for example, advertising fees) are fully deductible. However, the deduction may need to be claimed on a GST-exclusive basis, depending on whether the beneficiary is GST registered and whether the property is rented out through an online marketplace (see from [85]).

63. Mixed expenses – those that relate to both the private use of the home and the rental activity – must be apportioned. Mixed expenses include things like rates, insurance, utility bills, and home loan interest. Again, these deductions may need to be claimed on a GST-exclusive basis.

64. Generally, the appropriate basis for apportionment will be as discussed in QB 25/01. But in some situations, a different basis may be required. For example, if a separate dwelling on the same property as the beneficiary's home is rented out, or if the home is vacant for 62 days or more in the year. QB 25/02 explains how to work out which tax rules apply.

11 From 1 April 2024, up to 80% of the interest on the loan can be claimed, and from 1 April 2025 up to 100% of the interest can be claimed.

12 Deductible repairs and maintenance expenditure does not include expenditure on capital improvements (see **IS 12/03: Income tax – Deductibility of repairs and maintenance expenditure – general principles**).

13 Some councils may impose targeted rates in respect of properties used for short-stay accommodation.

65. Depreciation losses on chattels in the property owned by the beneficiary and available for use by paying guests can be deducted either in full or in part (depending on whether the chattels are used solely by paying guests). QB 25/01 explains how to calculate the percentage of depreciation losses that is tax deductible (except if the MUA rules apply – in which case see QB 25/03).

Allocation of deductions if the rental activity is loss-making

66. If the MUA rules do not apply and the rental activity is loss-making, the residential rental ring-fencing rules in subpart EL may limit the deductions that can be allocated to the income year.

67. Those rules will often not apply where the property the beneficiary is renting out is their main home. However, the rules could apply in some situations, for example, if a principal settlor of the trust has a separate main home, or if the property the beneficiary is renting out is not their main home.

68. Any deductions that cannot be allocated to the income year because of the residential rental ring-fencing rules will be carried forward to the next income year the beneficiary derives residential income.

69. There is more information about the residential rental ring-fencing rules in the Appendix to **IS 23/04** (from A48).

70. Where the MUA rules apply, there are separate rules called the expenditure quarantine rules that may apply in this situation if the rental activity is loss-making – see QB 25/03.

Trustees – income and deductions

71. In the family home context, it is likely that most of the property-related expenses will be incurred by the beneficiary who lives there. However, some expenses may be incurred by the trustees, for example, rates and property insurance.

72. Often the beneficiary who lives in the property will pay the property-related outgoings incurred by the trust as part of the arrangement that allows them to live in the property. The payment of those amounts by the beneficiary would be rental income to the trustees under s CC 1. However, this rental income would be offset as the trustees are able to deduct the expenditure, as it is incurred by them in deriving the rental income.

73. If the trust is non-active, the trustees **may not need to file a tax return**. A return would not be required if the trust:
    - is a complying trust (an ordinary New Zealand trust with New Zealand resident trustees and settlors);
    - is a non-active trust;
    - has submitted a non-active trust declaration – IR633 to Inland Revenue; and
    - has not stopped being a non-active trust since making the declaration.

74. A trust will be a non-active trust if it has not derived (or been deemed to have derived) any income for the year and does not have any deductions for the year. There also cannot have been any transactions involving assets of the trust that give rise to income to any person, or give rise to fringe benefits to any employee or former employee.

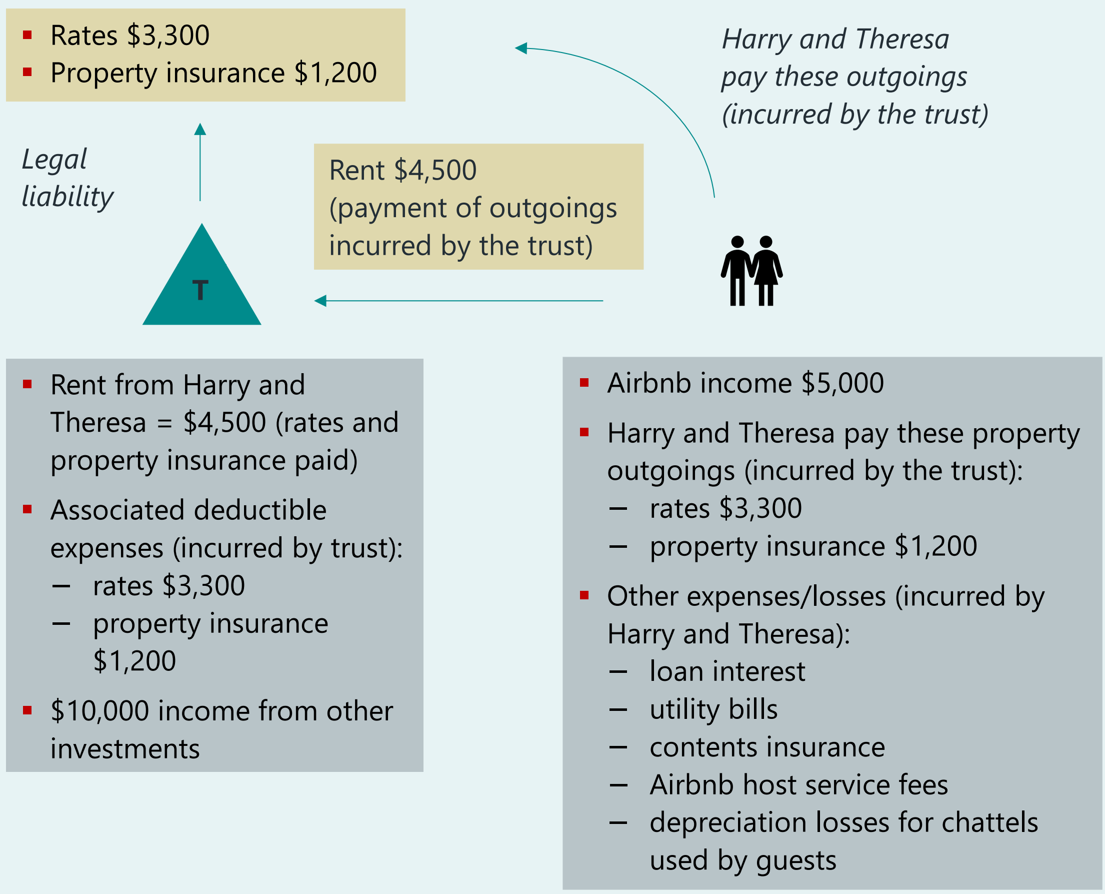
75. In determining whether a trust is non-active, the following payments are not taken into account (s 43B(3) of the Tax Administration Act 1994):

> **43B Trustees, administrators, or executors of certain trusts or estates not required to file returns**
>
> …
>
> (3) In determining whether a trust or estate complies with the requirements of subsection (2), no account shall be taken of any—
>
> (a) reasonable fees paid to professional persons to administer the trust or estate; or
>
> (b) bank charges or other minimal administration costs totalling not more than $1,500 in the tax year; or
>
> (c) income derived by the trustee of a trust or an administrator or executor of an estate during the tax year that would be reportable income, as defined in section 22D of the Tax Administration Act 1994, if the trust or estate were an individual, to the extent to which the total amount of that income does not exceed $1,000; or
>
> **(d) insurance, rates, interest, and other expenditure incidental to the occupation of a dwelling owned by the trust or estate and incurred by the beneficiaries of the trust or estate**.
>
> [Emphasis added]

76. So, if a beneficiary is paying the trustee-incurred outgoings for the property because they live there, while those amounts may technically be rent, if the trust does not otherwise have income or make any payments other than those mentioned at [75], it may be able to submit a non-active trust declaration (see the requirements at [73]). If the trust meets the requirements and does this, the trustees will not need to file a tax return so long as the trust continues to be non-active.

77. Trusts that **are not** non-active trusts will have to file a tax return. Example | Tauira 4 explains what rental income the trustees will have and what deductions they can claim when a beneficiary lives in property held in the trust, uses it to provide short-stay accommodation, and pays the outgoings incurred by the trustees.

Example | Tauira 4 – A beneficiary living in trust property pays property outgoings



Harry and Theresa's home is held in a family trust. They settled the trust when they bought the home, and they are beneficiaries of the trust. They have a spare room and rent it out on Airbnb, earning $5,000 from this during the income year.

Because they live in the property, Harry and Theresa pay the following outgoings that are incurred by the trust: the rates ($3,300 for the year) and the property insurance ($1,200 for the year).

Harry and Theresa have other expenses related to earning the Airbnb income: loan interest (the home loan is in their names), utility bills, contents insurance, and Airbnb host service fees. They also have depreciation losses for chattels in the home that guests can use.

Because Harry and Theresa are paying the outgoings for the property that are incurred by the trust (the rates and property insurance), on the basis they can live there, those amounts would be rent to the trust. The trust can deduct the amount of the rates and property insurance because it has incurred them, having a legal liability to pay them. The result is that the rent and the deductions for the trust net off. However, the trust has $10,000 income from other investments, so it is not a non-active trust. As such, the trustees need to file a tax return, which needs to include the rental income and associated deductions (even though they net off).

If Harry and Theresa meet the criteria to use Inland Revenue's standard-cost determination DET 19/02, they might choose to do that, to simplify their tax obligations. But otherwise, they will need to return all the Airbnb income they receive, and can deduct a portion of the rates, property insurance and other expenses (and depreciation losses) they have. QB 25/01 will help them work out what proportion of their expenses they can claim as deductions.

Could s GC 5 apply to deem adequate rent to be paid from the beneficiary to the trust?

78. Section GC 5 may apply where property is leased to someone who uses it to derive income. If no rent is payable by the lessee, or the rent is inadequate, s GC 5 could deem "adequate rent" to be paid by the lessee and derived by the lessor.

79. "Lease" in s GC 5 means a tenancy of any duration, including a sublease or bailment. As noted at [5], where a beneficiary of a trust lives in property held in the trust, there will be a tenancy at will, which meets the definition of lease.

80. Section GC 5 will only apply to certain leases.[14] This includes a lease by a person to a relative. "Relative" includes a person connected with another person by being the trustee of a trust under which a relative has benefitted or is eligible to benefit (s YA 1).

81. So, in a family trust situation, where a beneficiary is living in trust property and using it to derive income (for example, renting out a room for short-stay accommodation), s GC 5 could potentially apply to deem adequate rent to be paid by the beneficiary to the trust.

82. However, the Commissioner would not apply s GC 5 in this situation. This is because s GC 5 is aimed at ensuring income cannot be assigned to someone else through leasing income-producing property to a relative or related company at a nominal rent. That mischief is not present in the trust context, where a trust can legitimately allocate any income as beneficiary income. The Commissioner will not use s GC 5 to deem there to be adequate rent paid for a lease in a situation where the lease is not creating an opportunity for a tax benefit through the shifting of income from one person to another.

Provision of below market value accommodation to the beneficiary

83. If the trust is a complying trust (an ordinary New Zealand trust with New Zealand resident trustees and settlors), and the trustees allow a beneficiary to live in the trust-owned property rent-free or for less than market rent, this will be an exempt distribution from the trust (ss CW 53 and HC 20).

84. However, if the trust is a foreign trust or a non-complying trust, this will be a taxable distribution from the trust, and not subject to the ordering rules (s HC 15(6)). In these circumstances, there are special rules that determine the value of the distribution, see from [8.8] of **IS 24/01**.

Online marketplace rules

85. If the person renting out the property is not GST-registered and rents the property through an online marketplace like Airbnb, Bookabach, Booking.com or Holiday Houses, the marketplace operator will give the person a flat-rate credit of 8.5% of the value of the supply of short-stay accommodation.

86. The person has the option to treat the flat-rate credit as either:
    - excluded income (which is not subject to income tax, so is not included in the person's income tax return); or
    - assessable income (which is included in the person's income tax return).

    (Section CH 5B).

87. If the person renting out the property is not GST-registered and opts to treat the flat-rate credit as assessable income, all their expenses are deducted on a **GST-inclusive basis** (s DB 2).

14 Listed in s GC 5(2).

88. If the person renting out the property is not GST-registered and opts to treat the flat-rate credit as excluded income:

- Expenses that relate to nights when the dwelling was rented through an online marketplace must be deducted on a **GST-exclusive** basis. This is because the flat-rate credit is intended to recognise the GST on the expenses incurred when deriving this income that the person would have been able to deduct as input tax in their GST return if they were GST-registered.
- Expenses that relate to nights when the dwelling was rented out other than through an online marketplace are deductible on a **GST-inclusive basis**.

(Section DB 2).

89. If the person renting out the property is GST-registered, a flat-rate credit is not provided, and expenses are deductible on a **GST-exclusive basis**.

90. The rules are discussed in more detail in QB 25/03 and QB 25/04 and worked examples are provided.

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QB 25/06: How does an amalgamated company calculate its available subscribed capital following an amalgamation?

Issued | Tukuna: 4 April 2025

This question we've been asked explains how an amalgamated company calculates its available subscribed capital.

Key provisions | Whakaratonga tāpua

Income Tax Act 2007 – s CD 43

REPLACES | WHAKAKAPIA:

- **QB 13/02**: Income tax – Determining the "subscriptions" amount for an amalgamated company under the available subscribed capital rules
- **QB 14/05**: Income tax – ASC rules – Calculating the "subscriptions" amount for an amalgamated company when the shares of an amalgamating company are held by another amalgamating company

Question | Pātai

How does an amalgamated company calculate its available subscribed capital (ASC) following an amalgamation?

Answer | Whakautu

An amalgamated company calculates its ASC using the formula:

1 July 1994 balance + subscriptions – returns – look-through company returns

The purpose of the ASC formula is to determine the amount that shareholders have paid into a company as capital when subscribing for shares. The ASC of a company can be returned to shareholders tax-free in certain circumstances rather than being treated as a dividend.

The definitions of "subscriptions" and "returns" are modified for an amalgamated company.

The amalgamated company's "subscription" amount for a class of share will include the:

- total amount of consideration that the company received after 30 June 1994 for the issue of shares of the same class; and
- ASC of all shares in the amalgamating companies, provided that:
  - the amalgamating company's shares are of an equivalent class;
  - the amalgamating company's shares are not held directly or indirectly by an amalgamating company; and
  - the shares are not shares in the amalgamated company.
- The "returns" amount will increase if an amalgamating company holds shares in an amalgamated company and the shares are cancelled on amalgamation. The amalgamated company's ASC per share will reduce by the "returns" amount.

Key terms | Kīanga tau tāpua

Amalgamated company means the company that continues or survives after an amalgamation or a new company (ie, the continuing company).

Amalgamating company means a company that amalgamates with one or more other companies under an amalgamation. Generally, it includes both any company that ceases to exist after the amalgamation and the continuing company.

ASC means the amount that shareholders have paid into a company as capital when subscribing for shares. It is calculated using the formula in s CD 43(1).

Concessionary amalgamation means an amalgamation that is a "resident's restricted amalgamation" (as defined in s FO 3) and receives concessionary tax treatment under subpart FO.

Non-concessionary amalgamation means an amalgamation either that does not meet the criteria for a concessionary amalgamation or that the companies elect not to treat as a concessionary amalgamation.

Explanation | Whakamāramatanga

Introduction

1. This question we've been asked (QWBA) explains how an amalgamated company calculates its ASC following an amalgamation.
2. We have been asked to consider how the "subscriptions" and "returns" amounts are modified for an amalgamated company.
3. This item applies to both concessionary amalgamations and non-concessionary amalgamations.
4. See **IS 25/10**: **Income tax and GST – Amalgamations** for tax guidance on amalgamations.
5. All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This QWBA replaces previous publications

6. In 2013, the Commissioner issued a QWBA on determining the "subscriptions" amount for an amalgamated company under the ASC rules (**QB 13/02**: **Income tax – Determining the "subscriptions" amount for an amalgamated company under the available subscribed capital rules**).
7. To complement QB 13/02, the Commissioner issued a further QWBA on the topic: **QB 14/05**: **Income tax – ASC rules – Calculating the "subscriptions" amount for an amalgamated company when the shares of an amalgamating company are held by another amalgamating company**.
8. This QWBA replaces QB 13/02 and QB 14/05 from the date of issue.

Formula for calculating available subscribed capital

9. A company, including an amalgamated company, calculates its ASC using the formula:[1]

   1 July 1994 balance + subscriptions – returns – look-through company returns

10. The purpose of the ASC formula is to determine the amount that shareholders have paid into a company as capital when subscribing for shares. The ASC of a company can be returned to shareholders tax-free in certain circumstances rather than being treated as a dividend.
11. In this QWBA we focus on the "subscriptions" and "returns" components of the formula because these are specifically modified in an amalgamation.

"Subscriptions" is the total amount of consideration received

12. The "subscriptions" amount of a company is the total amount of consideration that the company received after 30 June 1994 and before the calculation time for the issue of shares of the same class.[2]

1 s CD 43(1)
2 s CD 43(2)(b)

13. The subscriptions amount for an amalgamated company includes an amount equal to the ASC at the time of the amalgamation of all shares in the amalgamating companies that are:[3]
    - of an equivalent class to the class; and
    - not held directly or indirectly by an amalgamating company; and
    - not shares in the amalgamated company.
14. Each of these requirements is considered further below.
15. The subscriptions amount does not include any other amount for the agreement of shareholders to the amalgamation and the resulting property acquisitions by the amalgamated company.[4]

Shares are of an equivalent class

16. The subscriptions amount for an amalgamated company includes an amount equal to the ASC at the time of the amalgamation of all shares in the amalgamating companies that are of an equivalent class to the class of shares in the amalgamated company.[5]
17. To determine whether the shares of an amalgamating company are of an equivalent class to those of the amalgamated company, the amalgamating company's constitution and any shareholder agreements should be reviewed. Factors to consider are whether the amalgamating company's shares carry the same:
    - shareholder decision-making rights;
    - rights to be paid profits that the company distributes; and
    - rights to the distribution of assets on the cancellation of shares.

Shares are not held directly or indirectly by an amalgamating company

18. The subscriptions amount for an amalgamated company does not include an amount equal to the ASC of shares in an amalgamating company if another amalgamating company holds (directly or indirectly) the amalgamating company's shares.[6]
19. The reason for excluding the ASC of subsidiaries from the ASC calculation is to avoid the double-counting of capital that the underlying shareholders have introduced. The underlying shareholders have subscribed for the shares in the parent company, and an amount of ASC equivalent to that value should be included only once for the amalgamated company. Example | Tauira 1 calculates an amalgamated company's ASC where it holds shares in the amalgamating company. Example | Tauira 2 calculates an amalgamated company's ASC where the shares in the amalgamating company are not held directly or indirectly by an amalgamating company.

Shares are not the amalgamated company's shares

20. As discussed at [12] the "subscriptions" amount of a company (which includes an amalgamated company) is the total amount of consideration that the company received after 30 June 1994 and before the calculation time, for the issue of shares of the same class.
21. As the subscriptions amount for an amalgamated company "includes" the ASC of all shares in the amalgamating companies and an amalgamated company is also an amalgamating company, this requirement prevents the amalgamated company's subscriptions from being counted twice.[7]

3 s CD 43(15). Section CD 43(2)(b) is subject to s CD 43(15). The phrase "subject to" indicates that one provision qualifies, modifies or changes another. The phrase also indicates which provision is to prevail in the event of a conflict: *C & J Clark Ltd v Inland Revenue Commissioner* [1973] 1 WLR 905; *Harding v Coburn* [1976] 2 NZLR 577; and *Re Tasman Pacific Airlines of NZ Ltd (in rec & liq)* [2002] 1 NZLR 688

4 s CD 43(15)(b)

5 s CD 43(15)(a)(i)

6 s CD 43(15)(a)(ii)

7 s CD 43(15)(a)(iii)

"Returns" is the total consideration paid on cancellation

22. The "returns" amount of a company is the total amount of consideration that the company has paid after 30 June 1994 and before the calculation time, on the cancellation of shares of the same class and the consideration was excluded from being a dividend under specific provisions.[8]

Modifying the "returns" amount for an amalgamated company

23. The "returns" component of the ASC formula is modified where an amalgamating company holds shares in an amalgamated company, and the shares are cancelled on amalgamation.[9]

24. The effect of the modification is to increase the "returns" amount (reducing the amalgamated company's ASC) by the amount calculated using the following formula:

    cancelled shares x ASC per share

    where:[10]

    "cancelled shares" is the number of cancelled shares

    "ASC per share" is the ASC per share calculated under the slice rule of each cancelled share immediately before the amalgamation.

25. Example | Tauira 3 illustrates a situation where the "returns" component of the ASC is modified because the amalgamating company holds shares in the amalgamated company that are cancelled on amalgamation.

8 s CD 43(2)(c)

9 s CD 43(24)

10 s CD 43(25)

Examples | Tauira

26. The following examples provide guidance on how to apply the law.

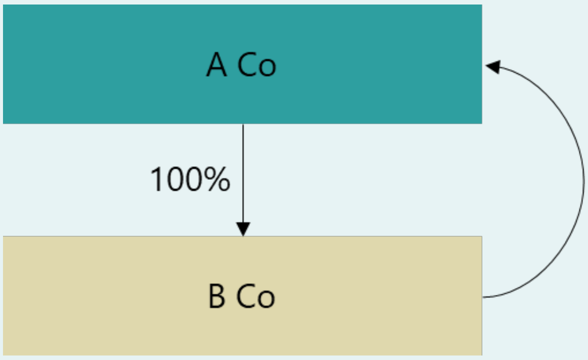
Example | Tauira 1 – ASC of an amalgamated company that held shares in the amalgamating company

On 16 February 2021, A Co was incorporated and issued 2,200 ordinary shares for $1 each.

Then on 17 March 2022, B Co was incorporated and issued 1,500 ordinary shares for $1 each to A Co.

Neither A Co nor B Co is a look-through company.

A Co and B Co amalgamate. The amalgamation provides for A Co to continue as the amalgamated company and for B Co's shares to be cancelled.



The subscriptions amount of A Co includes its share capital ($2,200) (counted only once).[11]

An amount equivalent to B Co's ASC ($1,500) is not included in A Co's subscriptions because an amalgamating company (A Co) holds all of B Co's shares.[12]

As the shares of A Co (the amalgamated company) are not cancelled on amalgamation the "returns" component of the ASC formula is not modified.

A Co calculates its ASC as follows:

1 July 1994 balance = $0

Subscriptions = $2,200 + $0

Returns = $0

Look-through company returns = $0

ASC = $2,200

11 s CD 43(2)(b) and CD 43(15)(a)(iii)
12 s CD 43(15)(a)(ii)

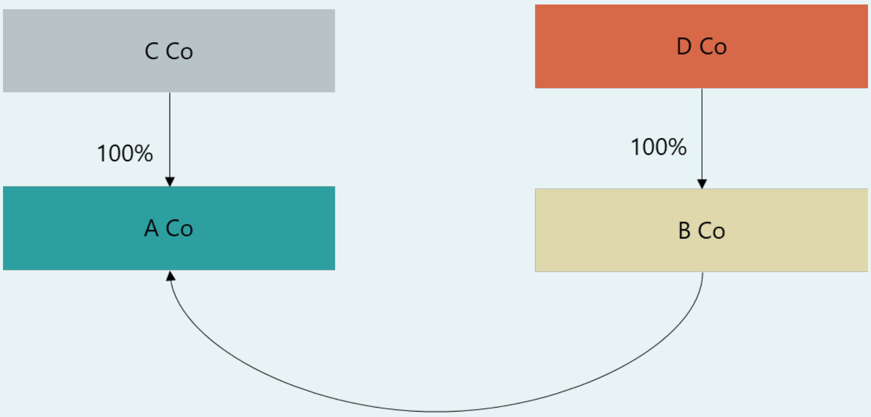
Example | Tauira 2 – ASC of an amalgamated company that did not hold shares in the amalgamating company

On 16 February 2021, A Co was incorporated and issued 2,200 ordinary shares for $1 each to C Co.

Then on 17 March 2022, B Co was incorporated and issued 1,500 ordinary shares for $1 each to D Co.

Neither A Co nor B Co is a look-through company.

A Co and B Co amalgamate. The amalgamation provides for A Co to continue as the amalgamated company and for B Co's shares to be cancelled.



The subscriptions amount of A Co includes its share capital ($2,200) (counted once only).[13]

As an amalgamating company does not own B Co directly or indirectly, and as B Co is not the amalgamated company, an amount equivalent to B Co's ASC ($1,500) is included in A Co's subscriptions amount.[14]

As the shares of A Co (the amalgamated company) are not cancelled on amalgamation, the "returns" component of the ASC formula is not modified.

A Co calculates its ASC as follows:

1 July 1994 balance = $0

Subscriptions = $2,200 + $1,500

Returns = $0

Look-through company returns = $0

ASC = $3,700

13 s CD 43(2)(b) and CD 43(15)(a)(iii)

14 s CD 43(15)(a)(i), (ii) and (iii)

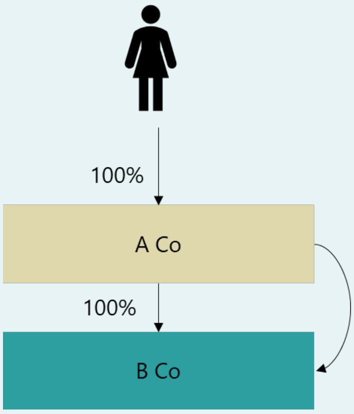
Example | Tauira 3 – ASC of amalgamated company where its shares are held by the amalgamating company and cancelled on amalgamation

On 16 February 2021, A Co was incorporated and issued 2,200 ordinary shares for $1 each.

Then on 17 March 2022, B Co was incorporated and issued 1,500 ordinary shares for $1 each to A Co.

Neither A Co nor B Co is a look-through company.

A Co and B Co amalgamate. The amalgamation provides for B Co to continue as the amalgamated company, for B Co's shares to be cancelled, and A Co's shares to convert into B Co's shares.



The subscriptions amount of B Co includes its share capital ($1,500) (counted once only).[15]

As an amalgamating company does not own A Co directly or indirectly, and as A Co is not the amalgamated company, an amount equivalent to A Co's ASC ($2,200) is included in B Co's subscriptions amount.[16]

As the shares of B Co (the amalgamated company) are cancelled and an amalgamating company owns B Co, the "returns" component in the ASC formula is modified.[17]

B Co calculates its ASC as follows:

1 July 1994 balance = $0

Subscriptions = $1,500 + $2,200

Returns = $1,500

Look-through company returns = $0

ASC = $2,200

15 s CD 43(2)(b) and CD 43(15)(a)(iii)

16 s CD 43(15)(a)(i), (ii) and (iii)

17 s CD 43(24) and (25)

References | Tohutoro

Legislative references | Tohutoro whakatureture

Income Tax Act 2007 – ss CD 43

Case references | Tohutoro kēhi

C & J Clark Ltd v Inland Revenue Commissioner [1973] 1 WLR 905

Harding v Coburn [1976] 2 NZLR 577

Re Tasman Pacific Airlines of NZ Ltd (in rec & liq) [2002] 1 NZLR 688

Other references | Tohutoro anō

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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 25/07: GST – Zero-rating, input tax deductions, shortfall penalties

Decision date | Rā o te Whakatau: 23 January 2025

Issue date | Rā Tuku: 26 March 2025

Subjects | Kaupapa

GST: entitlement to charge GST at 0%, input tax deductions, shortfall penalties

Taxation laws | Ture tāke

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

Summary of facts | Whakarāpopoto o Meka

1. The Taxpayer, an individual, claimed they were involved in the taxable activity of freight-forwarding and acting as an agent for overseas customers.
2. The Taxpayer's activity was small, with few transactions and a lack of invoices provided as evidence of these transactions.
3. The Taxpayer was GST registered on a payments basis. The Taxpayer returned zero-rated sales and claimed input tax deductions in the periods in dispute.
4. Customer and Compliance Services (CCS) questioned the input tax deductions claimed and the existence of a taxable activity.

Issues | Take

5. This dispute concerned whether the Taxpayer was entitled to charge GST at 0% on supplies of goods or services or to input tax deductions claimed. Specifically, whether:
   - the Taxpayer was carrying on a taxable activity under s 6;
   - the Taxpayer was entitled to input tax deductions, if a taxable activity was carried on; and
   - the Taxpayer was liable for shortfall penalties for gross carelessness.
6. There was also a preliminary issue on the onus and standard of proof.

Decisions | Whakatau

7. The Tax Counsel Office (TCO) decided that the Taxpayer was not entitled to charge GST at 0% on supplies of goods or services, or input tax deductions. Specifically:
   - the Taxpayer was not carrying on a taxable activity under s 6;
   - even if the Taxpayer was found to be carrying on a taxable activity, the Taxpayer was not entitled to the input tax deductions claimed; and
   - the Taxpayer was liable for shortfall penalties for gross carelessness.

Reasons for decisions | Pūnga o ngā whakatau

Preliminary issue | Take tōmua: Onus and standard of proof

8. Except for proceedings relating to evasion or similar act or obstruction, the onus of proof is on the taxpayer to show that an assessment is wrong, why it is wrong, and by how much it is wrong.[1] However, if the taxpayer proves, on the balance of probabilities, that the amount of an assessment is excessive by a specific amount, the taxpayer's assessment must be reduced by the specific amount.[2]
9. The standard of proof required is the balance of probabilities.[3]
10. It is appropriate that the same onus and standard of proof be applied in the disputes process as in challenge proceedings. TCO considered whether the Taxpayer has discharged the onus of proof in the context of the issues raised by the parties in the dispute, based on the documentary evidence put before it.

Issue 1 | Take tuatahi: Was the Taxpayer carrying on a taxable activity under s 6?

11. Establishing whether the Taxpayer was carrying on a taxable activity was necessary to determine whether the Taxpayer was entitled to zero-rate their sales[4] and claim input tax deductions.[5]
12. The Taxpayer claimed that they had been carrying on a taxable activity since they registered for GST. However, CCS argued there was insufficient evidence of the Taxpayer carrying on a taxable activity, as such, the Taxpayer was not entitled to charge GST at 0% on any supplies of goods or services made or to the input tax deductions claimed.
13. Under s 6(1)(a), there are four requirements that must be satisfied to show there is a taxable activity:[6]
    - There must be an activity.
    - The activity must be carried on continuously or regularly by a person.
    - The activity must involve, or be intended to involve, the supply of goods and services to another person.
    - The supply or intended supply of goods and services must be made for a consideration.
14. The Taxpayer had provided insufficient evidence of the consignment of goods overseas and a related service fee. Insufficient evidence was provided to substantiate the claim that other activities (eg, other sales and export of goods overseas and marketing) were carried on either continuously or regularly.
15. There was no evidence that the Taxpayer was invoicing on a regular basis and there were periods where the Taxpayer did not invoice for any supplies.
16. The Taxpayer provided no evidence that the service fee was paid or that any consideration was received in relation to the stated supplies.
17. TCO concluded that the Taxpayer had not demonstrated they were carrying on a taxable activity. There was insufficient evidence to support an argument that any activity was carried out continuously or regularly and involved the supply of goods or services to another person for a consideration. As the Taxpayer was not carrying on a taxable activity, they were not entitled to charge GST at 0% on any supplies made by them or to the input tax deductions claimed.

Issue 2 | Take tuarua: Was the Taxpayer entitled to input tax deductions if they carried on a taxable activity?

18. TCO considered that even if the conclusion that the Taxpayer was not carrying on a taxable activity was wrong, the Taxpayer was not entitled to the input tax deductions claimed.

1 Section 149A(2) of the TAA. See also *Case V17* (2002) 20 NZTC 10,192, *Accent Management Ltd v CIR* (2005) 22 NZTC 19,027 (HC), and *Vinelight Nominees Ltd v CIR (No 2)* (2005) 22 NZTC 19,519 (HC).

2 Section 138P(1B) of the TAA.

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

4 Sections 11, 11A, 8.

5 Section 20(3C).

6 *Case 14/2016* [2016] NZTRA 14, (2016) 27 NZTC 3-036 at [63]– [70].

19. The requirements for deductibility are:
    - The goods or services must have been acquired.[7]
    - The goods or services acquired must have been used for, or intended to be used in, making taxable supplies (s 20(3C)).
    - Tax invoice requirements must be met (s 24).
20. Where any registered person makes a taxable supply of goods and services to an agent who is acting on behalf of a principal, the supply is deemed to be made to the principal and not the agent.[8] The agent therefore does not "acquire" the goods or services.[9]
21. Whether the Taxpayer was an agent depended on the legal agreements between the Taxpayer and any potential principal. No evidence was provided of the relationship between the Taxpayer and their customers. TCO concluded that the Taxpayer had not satisfied the onus of establishing they acquired the relevant goods and services.
22. If it were shown the Taxpayer did in fact acquire the relevant goods and services, TCO considered the Taxpayer would only be entitled to the input tax deduction claimed for the GST component for one tax invoice (where a valid tax invoice had been provided). TCO considered the Taxpayer had failed to provide sufficient documentation to support their entitlement to the other input tax deductions.
23. TCO concluded the Taxpayer was not entitled to the input tax deductions claimed on the basis the Taxpayer had not satisfied the onus of proving that they acquired the relevant goods and services.

Issue 3 | Take tuatoru: Does the shortfall penalty apply?

24. In this issue, all legislative references are to the Tax Administration Act 1994 unless otherwise stated.
25. The Taxpayer took tax positions that they were entitled to input tax deductions. The Taxpayer's tax positions were not correct and there were tax shortfalls.
26. The issue was whether the Taxpayer was liable for a shortfall penalty for gross carelessness in terms of s 141C, or alternatively, for not taking reasonable care in terms of s 141A.
27. Section 141C imposes a shortfall penalty for gross carelessness 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 been grossly careless in taking the taxpayer's tax position. Gross carelessness means doing or not doing something in a way that, in all 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.[11]
    - 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.[12]
        - A person who takes reasonable care is not grossly careless.[13]
28. The penalty payable for gross carelessness is 40% of the resulting tax shortfall.

7 *CIR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 (CA) at 13,193.

8 S 60(2).

9 *Case T35* (1997) 18 NZTC 8,235.

10 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).

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

12 *Case W4* at [60]; Case 9/2014 (2014) 26 NZTC 2-019 at [88].

13 *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.

29. TCO concluded the Taxpayer was grossly careless when taking these positions:
    - The Taxpayer was aware at the time of the record keeping requirements.
    - A reasonable inference from the Taxpayer's conduct was that adequate records did not exist at the time the tax positions were taken.
    - This created a high risk of tax shortfalls that was serious and obvious and would have been foreseen by a reasonable person in the circumstances.
    - The Taxpayer had a complete or high level of disregard for the consequences by taking tax positions without records to support those positions.
30. TCO found that the Taxpayer had not shown their tax positions were acceptable tax positions.
31. A Taxpayer does not take an unacceptable tax position to the extent to which they have taken their position because they have relied on a Commissioner's official opinion (s 141B(1D)). The Taxpayer had not provided any objective evidence that they received or relied on a Commissioner's official opinion in taking the tax positions.
32. Section 141A imposes a shortfall penalty for not taking reasonable care on a taxpayer if the following requirements are satisfied:[14]
    - 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:[15]
        - 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.[16]
33. The penalty payable for not taking reasonable care is 20% of the resulting tax shortfall.
34. TCO found that the requirements for shortfall penalties for not taking reasonable care were also met. However, the shortfall penalty for gross carelessness applied because it is the higher penalty.[17]
35. Accordingly, TCO concluded that the Taxpayer was liable for the shortfall penalties for gross carelessness proposed by CCS.

14 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).

15 *Case W4* (2003) 21 NZTC 11,034.

16 See also *Case W3* (2003) 21 NZTC 11,014 and *TRA 007/12* [2014] NZTRA 08, (2014) 26 NZTC 2-018.

17 Section 149(2) and (3) TAA 1994.

REGULAR CONTRIBUTORS TO THE TIB

Tax Counsel Office

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

Legal Services

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

Technical Standards

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

Policy

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