- improving the tax and social policy rules
- base erosion and profit-sharing — the taxation of multinational companies
- business transformation and better public service.

See further at ¶1-025.

NZ ratifies multilateral tax convention

On 22 November 2013, the Minister of Revenue, the Hon Todd McClay, announced that New Zealand has now taken the final procedural step for ratification of the multilateral Convention on Mutual Administrative Assistance in Tax Matters.

New Zealand signed the Convention on 26 October 2012.

The Double Tax Agreements (Mutual Administrative Assistance) Order 2013 (SR 2013/437) was notified in the *New Zealand Gazette* on 24 October 2013. The Order came into force on 21 November 2013. The Order gives effect to the Convention on Mutual Administrative Assistance in Tax Matters, amended by 2010 Protocol (the Convention).

Now that the final procedural step for ratification of the Convention has been taken by New Zealand, Inland Revenue will be able to engage in the following forms of cooperation on tax matters with the tax authorities of other signatory countries:

- exchange of information
- assistance in recovery of tax, and
- service of documents.

The Convention will come into force for New Zealand on 1 March 2014.

Chapter 1 TAX SYSTEM

¶1-010 Introduction

This chapter aims to provide an outline of the New Zealand income tax system.

The statutory basis of income tax in New Zealand is the Income Tax Act 2007 and the Tax Administration Act 1994. Together, these Acts are the latest in a series of statutes, dating back to the late 1800s, that deal with a tax on income. These Acts are the prime source of all the current law on the subject and an understanding of their basic provisions is essential to anyone studying the subject or dealing with income tax problems. Tax legislation is possibly the most complicated area of legislation in New Zealand and is subject to numerous amendments every year.

The passing of the Income Tax Act 2007 in December 2007 completed the project to rewrite New Zealand's income tax legislation. The 2007 Act came into effect on 1 April 2008. For a discussion of the rewritten Act, see ¶1-056.

The Income Tax Act deals with income tax and other taxes derived from the income tax system. Fringe benefit tax, qualifying company election tax and resident and non-resident withholding taxes are examples of taxes imposed under the main taxing statute. Amendments are made to the Act each year and are read as though they were part of the principal Act, applying from the time specified in the amendment Act. This means that the Act, as originally passed, does not state the law as it will apply in later years. The Act must be read along with its subsequent amendments.

Inland Revenue (IR) administers the tax system. IR's powers and responsibilities are set out in the Tax Administration Act. This Act charges the IR's chief executive, the Commissioner of Inland Revenue, with the care, management and collection of the taxes covered by the Inland Revenue Acts. In carrying out his or her duty, the Commissioner is required to collect, over time, the highest net revenue practicable within the law. The Commissioner is authorised to make binding rulings, assessments, determinations relating to financial arrangements and determinations for other purposes. The Tax Administration Act also authorises the Governor-General to issue directions to the Commissioner of Inland Revenue, but only in relation to the

administration of the Inland Revenue Acts. These directions are made by Order in Council. The Governor-General is not authorised to give directions concerning the tax affairs of individual taxpayers or the interpretation of tax law.

The Tax Administration Act and the Income Tax Act require taxpayers to self-assess their income tax liabilities. However, it is the Commissioner who administers the tax system and issues assessments on default or after investigations.

Regulations for various purposes under the Income Tax Act may be made by the Governor-General. Any regulations and orders made under earlier Acts continue to have effect as though they were made under the Income Tax Act, unless they are specifically revoked. Regulations have been made to deal with matters such as general administration and machinery provisions (eg the Taxation Review Authorities Regulations 1998, which outline the disputes resolution procedures). Numerous orders have been made under specific sections of the Act relating to very specialised matters.

¶1-020 The tax statutes

A brief history of taxation

The origins of income tax can be traced to the Napoleonic Wars. To finance the conduct of the wars, a duty known as income tax was imposed in the United Kingdom, as a temporary measure, from 1799 to 1802 and 1803 to 1816. It was reintroduced as a temporary measure in 1842, but this time the duty was never removed. Income tax was first imposed in New Zealand by the Land and Income Assessment Act 1891. That Act, with subsequent amendments, was consolidated in 1900. Further consolidating Acts were passed in 1908, 1916, 1923 and 1954. Various other types of tax were imposed by those Acts. The importance of income tax increased, however, and the proportion of revenue collected by that tax rose, particularly compared with that from land tax, until it was the dominant source of Government revenue. In 1976 Parliament split the Land and Income Tax Act 1954 into two Acts. These were the Income Tax Act 1976 and the Land Tax Act 1976 (the latter being abolished from 31 March 1992 by the Land Tax Abolition Act 1990). In December 1994 Parliament enacted the Income Tax Act 1994, the Tax Administration Act 1994 and the Taxation Review Authorities Act 1994, marking the first phase in a four-step process to rewrite the Income Tax Act 1976. In July 1996 the Taxation (Core Provisions) Act 1996 rewrote Pts A and B of the Income Tax Act 1994. In May 2004 the Income Tax Act 2004 received Royal assent. Briefly, this Act rewrote Pts A–E and Y of the Income Tax Act 1994. In November 2007, the Income Tax Act 2007 was enacted, containing the rest of the rewritten Parts and Schedules and re-enacting the Parts enacted under the 2004 Act. It applies from the 2008/09 income year. See further at ¶1-056.

The significance of taxation

Income tax is important for two reasons. First, it is the Government's principal source of revenue. In the "IRD — Annual Report" document produced by Inland Revenue, published October 2013 at 17, it shows the breakdown of revenue collected in the 2012/13 year by the three key tax types as:

- income tax — 73% of revenue
- GST — 26% of revenue, and
- other indirect taxes, including excise taxes on tobacco, alcohol and petrol — 1% of revenue.

This revenue is applied to finance many of the benefits offered by New Zealand's welfare system. Secondly, it is a measure that influences most people's standard of living. Most adults pay income tax but any who did not do so would be financially better off. Many taxpayers see income tax as an appropriation of their earnings. Many businesses, particularly the large-scale

ones, see income tax as a business cost that must be kept to a minimum. Consequently, taxpayers are usually conscious of the possible tax implications when they come to arrange their financial affairs, and this outlook on the part of taxpayers accounts for many features of the income tax system. It has required the creation of a large bureaucratic organisation to administer and enforce the system, with the administrators being given wide powers to inquire into people's financial affairs. It has also led to the pattern of constant amendment required not only to plug gaps but also to expand the tax base.

¶1-025 Tax policy work programme

In a speech on 8 November 2013 to the New Zealand Institute of Chartered Accountants' tax conference in Auckland, the Revenue Minister, the Hon Todd McClay, announced the Government's tax policy work programme for the next 18 months. The new tax policy work programme aims to support the Government's priorities for growth and productivity, and delivering better public services. There are three main areas of focus for the new tax policy work programme:

- making further improvements to the tax and social policy rules within the Government's broad-base, low-rate tax framework — ensuring that the tax system is well maintained, kept up to date and continually improved
- continuation of the Government's reform of our international tax rules and addressing base erosion and profit shifting — so New Zealand is an attractive place to do business and invest in while strengthening our tax rules to ensure that overseas companies pay their fair share of tax in New Zealand, and
- sharpen the focus on tax policy development work to support Inland Revenue's business transformation programme and the Government's goal of better public services for New Zealanders.

Details of the Government's tax policy work programme are as follows:

Improving current tax settings within a broad-base, low-rate tax framework	
Research and development (R&D) tax losses	Taking forward the Government's proposal to cash-out R&D tax losses in the income year in which they arise.
Black-hole R&D expenditure	Considering the tax deductibility of capital R&D expenditure, in appropriate circumstances.
Interaction of loss grouping and imputation credits	Considering how to preserve the benefit of loss offsetting for shareholders of non-wholly-owned groups.
Review of tax rules for closely-held companies	Considering simplification, technical and base maintenance issues that arise under current tax rules applying to closely-held companies, including improving the overall coherence of the rules. These include the rules for look-through companies and other close company regimes.
Tax pooling	Reviewing whether the tax pooling rules are operating as intended.
Depreciation on buildings	Considering ongoing boundary and remedial issues stemming from removal of depreciation on buildings.

Tax treatment of government grants	Reviewing the current income tax treatment of government grants.
Financial reporting	Setting minimum financial reporting requirements for companies and certain other business taxpayers.
Taxation of annuities	Scoping a review of the tax settings for annuities.
Remedial work programme	Considering remedial matters arising from recently enacted legislation as well as other priority tax law coherence and maintenance issues. Recently enacted regimes include: ■ the controlled foreign company rules ■ the life insurance rules ■ the mixed-use assets rules ■ social assistance income base broadening rules ■ the new child support regime.
KiwiSaver employer and employee contributions	Supporting Inland Revenue's review of the process for the reporting, recording and collection of KiwiSaver employer and employee contributions, and ensuring a visible and cohesive approach to non-payment of KiwiSaver contributions.
Child support overseas debt	Considering whether there are further ways to address the problem of overseas child support debt.
Student loan overseas-based borrowers	Providing continued policy support for the ongoing compliance strategy to encourage compliance by overseas-based borrowers.
International tax reform and addressing base erosion and profit shifting	
Active income exemption for offshore branches	Aligning the treatment of offshore branches with the current regime for controlled foreign companies. An active income exemption will mean that foreign business income or losses will not be included in New Zealand tax assessments.
Mutual recognition of imputation credits	Working to progress mutual recognition of trans-Tasman imputation credits which would see both New Zealand and Australia recognising company tax paid in the other jurisdiction for imputation purposes.
Profit shifting using related-party debt	Examining problems with the thin capitalisation and transfer pricing rules. These rules are designed to prevent profit shifting by non-residents who fund their New Zealand investment using related-party debt that gives rise to deductible interest payments.
Foreign hybrid instruments and entities	Exploring whether New Zealand should restrict interest deductions on hybrid instruments where the interest payment is not taxed in the foreign jurisdiction. Examining the need for an anti-arbitrage rule for offshore entities to prevent double non-taxation or double deductions.
Non-resident withholding tax (NRWT) on related-party debt	Addressing problems with the application of NRWT to interest on related-party debt.

Approved issuer levy (AIL) disclosure requirements	Considering a requirement that all AIL payers provide more information relating to lenders.
GST and online shopping	Consulting with the public on GST issues raised by the increasing use of online shopping on overseas websites.
Double tax agreements and tax information exchange agreements	Negotiating new agreements to maintain and expand the network.
Business transformation and better public services	
Review of the tax secrecy provisions (s 81 of the Tax Administration Act 1994)	Addressing a range of secrecy/privacy issues, including enabling data to be made available to interested parties for research purposes and supporting the Ministry of Justice review of the Privacy Act 1993.
Information sharing	Advancing work in the following areas: ■ **Information sharing with the social welfare sector** — Information sharing within the wider social services clusters to prevent and recover debt and prevent fraud. ■ **Information sharing with business regulators** — Information sharing with business regulators for the purpose of ensuring compliance and efficient government administration. ■ **Information sharing in relation to serious crime** — Information sharing with law enforcement agencies to enable the detection and prevention of serious crime.
Business transformation — enabling secure digital services	Ensuring that the policy and legislative framework is fit for purpose to enable the implementation and delivery of secure digital services.
Business transformation — collection of GST and PAYE information	Ensuring that the policy and legislative framework is fit for purpose to improve and streamline the collection of PAYE and GST information.
Encouraging compliance	Reviewing the interest, penalty and debt rules to ensure that the rules encourage taxpayers to comply with their tax obligations.
Simplifying the tax and transfer system	Considering whether the tax and transfer system can be simplified either legislatively or operationally to reduce complexity for individuals.
21st century tax administration	Identifying and scoping the directions or steps, from a tax administration perspective, to ensure that the policy and legislative framework facilitates and supports business transformation, particularly stage 2 (streamlining income and business tax processes) and stage 3 (streamlining social policy processes).

LEGISLATIVE FRAMEWORK

¶1-030 Structure of the Tax Acts

The Income Tax Act 2007 is organised in a structure of Parts and Subparts and follows the structure, drafting style and features of the Interpretation Act 1999. The following is a brief analysis of the Act:

- Part A sets out the Act's purpose and principles for interpretation.
- Part B contains the core provisions.
- Part C defines income.
- Part D defines the extent to which deductions are allowed, and sets out how specific rules on deductions interact with the general rules on deductions.
- Part E deals with the timing and quantification of income recognition and deductions.
- Part F recharacterises certain transactions.
- Part G contains the provisions relating to tax avoidance and non-market transactions.
- Part H provides for the tax treatment of certain specific entities.
- Part I contains provisions relating to tax losses.
- Part L sets out the entitlement to tax credits.
- Part M deals with the tax credits which are paid in cash.
- Part O contains the rules relating to memorandum accounts.
- Part R contains the general collection rules relating to the payment and withholding of tax.
- Part Y contains the definitions used in the Act and related matters.
- Part Z contains the amendments, repeals, savings and transitional provisions.

Structure of the Tax Administration Act

The Tax Administration Act 1994 contains most of the provisions relating to administrative and procedural aspects of income tax law. Formerly, these provisions were found in the Income Tax Act 1976 and the Inland Revenue Department Act 1974 (except those provisions relating to the Taxation Review Authority). Among other things, the Tax Administration Act imposes reporting and disclosure obligations on taxpayers. It also sets out the offences and penalties imposed on taxpayers for breach of their tax obligations together with the procedure for disputes resolution. Its structure may be analysed as follows:

- Part 1 — purpose and construction
- Part 2 — the roles of the Commissioner and Inland Revenue
- Part 2A — taxpayer's principal tax obligations
- Part 2B — PAYE intermediaries, provisional tax and resident passive income
- Part 3 — information, record-keeping and returns
- Part 3A — income statements
- Part 3B — credits of tax

- Part 4 — secrecy
- Part 4A — disputes procedures
- Part 5 — determinations
- Part 5A — binding rulings
- Part 6 — assessments
- Part 7 — interest
- Part 8 — objections (relating to pre-1 October 1996 assessments)
- Part 8A — challenges (to notices of disputable decisions issued after 1 October 1996)
- Part 9 — penalties
- Part 10 — recoveries
- Part 10A — tax recovery agreements
- Part 10B — transfers of excess tax
- Part 11 — remission, relief, and refunds
- Part 12 — offences and penalties (repealed)
- Part 13 — miscellaneous, and
- Part 14 — transitional provisions and savings.

Taxation Review Authorities Act and Regulations

The law relating to Taxation Review Authorities, whose function is to decide on challenges to assessments of taxes and to other decisions or determinations, is found in the Taxation Review Authorities Act 1994 and the Taxation Review Authorities Regulations 1998.

¶1-040 Fixing the tax rates [TAA s 92A]

Income tax rates are fixed annually. This is because of the constitutional convention that income tax should be imposed only on a yearly basis and that the Crown's ability to collect revenue be subject to Parliament's consent. The rates are fixed by an Act referred to as the annual taxing Act. In practice, such an Act simply adopts the tax rates set out in sch 1 to the Income Tax Act 2007. To remove the necessity of passing a separate Act each year for the sole purpose of fixing the tax rates, the rates may be set as part of a wider amending Act.

The Taxation (Annual Rates, Returns Filing, and Remedial Matters) Act 2012 set the rates for the 2012/13 tax year. The rates for the 2013/14 tax year are proposed to be set by cl 3 of the Taxation (Annual Rates, Foreign Superannuation, and Remedial Matters) Bill (112-1) when enacted.

If an annual taxing Act is not passed, there is a savings provision in s 92A of the Tax Administration Act 1994 which enables the assessment for a tax year at the basic rates set out in sch 1 to the Income Tax Act. Such an assessment is not invalidated by the fact that it may have been made before the passing of an Act setting rates for the year concerned. Even without that provision, revenue would continue to flow to the Crown if Parliament did not sit or did not pass an annual taxing Act. This is because the PAYE tax deduction system under the principal Act would continue to operate.

Chapter 9 TRADING STOCK

¶9-001 Current trading stock rules [IT07 subpart EB]

Trading stock is property that a person who owns or carries on a business has for the purpose of selling or exchanging in the ordinary course of the business.

For any business, especially manufacturers, distributors or retailers, the method chosen to record and value trading stock on hand at year-end has a major impact on the bottom line profit. See ¶9-002.

Rules for the valuation of trading stock effectively require trading stock to be valued as at the end of each income year. The objective is to require the recognition, for income tax purposes, of the fluctuation in value for the income year of the trading stock maintained by a business. This is achieved by treating:

- the value of trading stock at the end of the income year as income, and
- the value of trading stock at the start of the following income year as an allowable deduction.

The trading stock value at the start of the following income year is the same as the closing value at the end of the prior year, that is, a common value applies.

This chapter looks at the role trading stock plays in calculating net income, the types of products making up trading stock and the methods that are available to value it.

Features of the current trading stock rules are:

- the valuation of trading stock by persons other than low-turnover traders, either at cost or at market selling value (only if lower than cost)
- the use of financial reporting standards to value stock at cost
- replacement price and discounted selling price may be used to approximate cost if these methods are used by the taxpayer for financial reporting purposes
- obsolescence is a factor in the market selling value calculation rather than being the subject of a separate set of rules
- simpler trading stock rules for low-turnover traders, ie persons (including associates of the person) with turnover of less than $3m

- an exemption from the trading stock rules for persons with a turnover of not more than $1.3m in an income year, and
- the valuation of shares, options or other excepted financial arrangements is to be at cost only.

Subpart EC applies to value livestock unless it is held as trading stock in which case subpart EB will apply (see ¶27-235).

¶9-002 Trading stock and effect on net income [IT07 ss BD 3, BD 4, CH 1, DB 49, EA 1, EB 1, EB 3, EB 4, EB 23, YA 1]

Before a taxpayer can calculate net income or net loss for their business for an income year, the amount of the cost of goods sold during the year must be determined. This is arrived at by using the following formula:

opening stock + total purchases in the year – closing stock = cost of goods sold

For tax purposes, the cost of goods sold takes into account the trading stock held at the beginning of the year and the purchases made during the year, but it does not include the trading stock on hand at the end of the year. Year-end trading stock instead becomes part of the cost of goods sold in the following year (as opening stock). Only by using this formula can the person properly match the year's sales with the cost of those sales.

The trading stock rules reflect this approach. These rules apply to the trading stock of any person who owns or carries on a business.

The value of trading stock at the beginning of the year (opening value) is treated as a deduction for that income year. The value of the trading stock at the end of the income year (closing value) is income for the year. The difference between the two is taken into account in calculating the net income or net loss for that income year.

Example:

A company buys up old washing machines and refrigerators and renovates them for resale. For the 2013 income year, it had opening stock of $40,000 (as at 1 April 2012) and closing stock of $65,000 (as at 31 March 2013). Its annual sales came to $90,000 and it spent $30,000 acquiring old units, $35,000 on renovation and labour, and $2,000 on new parts during the year. The amount to be taken into account when calculating the company's net income or net loss for that year is as follows:

	$	$
Sales		90,000
less cost of sales:		
opening stock	40,000	
purchases	30,000	
direct labour	35,000	
parts	2,000	
	107,000	
less closing stock	(65,000)	
		42,000
Amount to be included in net income for the year		48,000

The value of opening stock is the same as the closing stock value at the end of the previous income year. In the above example, the value of opening stock (or opening book value) in the 2013/14 income year would be $65,000.

Closing stock will increase net income for the year and some taxpayers may be tempted to value closing stock at its lowest possible value. Because closing stock must be valued using one of the four prescribed methods, opportunity for such tax planning is limited. See s EB 4.

Income from closing stock and deductions from opening stock are allocated to an income year under ss BD 3 and BD 4. Income is allocated to the income year it is derived and deductions are allocated to the income year they are incurred.

Under s EB 23 a person with turnover of less than $1.3m in the income year need not value trading stock at year-end if it can be reasonably estimated that the person has less than $10,000 worth of trading stock.

TRADING STOCK DEFINITIONS

¶9-005 Trading stock defined [IT07 ss EB 2, YA 1]

There are several different definitions of "trading stock", each of which applies according to the particular part or provision of the Income Tax Act 2007 being considered. The definition that generally applies for the Act, particularly for subpart EB (with the exception of s EB 24), is found in s EB 2.

The definition is inclusive, which means that it does not try to set out an exhaustive list of what is and what is not "trading stock".

For trading stock valuation purposes, "trading stock" is property that a person who owns or carries on a business has for the purpose of selling or exchanging in the ordinary course of business. It includes:

- work in progress or partly completed work that, if completed, would be trading stock
- materials that the person has for use in producing trading stock
- property on which expenditure is incurred that would be trading stock under the categories above if possession of it were taken, or
- property leased under a hire purchase agreement when that property is treated as having been acquired by the lessor under s FA 15 and is an asset of a business carried on by the lessor (this category applies to lessors only).

Ordinary course of business

The trading stock definition provides an express link between items held in the ordinary course of business and a business undertaking. The effect is that an asset is trading stock only when it is an asset in which the person's business deals or trades. An asset held on revenue account (eg an asset acquired with the purpose of resale) is not trading stock simply because the owner of the asset happens to carry on a business. This part of the definition was deliberately added to prevent any possible argument that an asset acquired by a person who is not in the business of trading in that asset could also be treated as trading stock.

Although services form part of inventory under NZIAS 2 *Inventories*, they are not trading stock for income tax purposes.

The following items are excluded (see s EB 2(3)) from the general definition:

- consumable aids
- spare parts not held for sale or exchange
- depreciable property
- an excepted financial arrangement that a life insurer has
- an excepted financial arrangement of a portfolio investment entity or the New Zealand Superannuation Fund that is subject to s CX 55 on disposal
- livestock not used in a dealing business
- land

- a financial arrangement subject to the financial arrangements rules or the old financial arrangements rules
- an emissions unit, and
- a non-Kyoto greenhouse gas unit.

A number of other definitions relevant to trading stock valuation under subpart EB include:

- closing stock
- cost
- financial statements
- generally accepted accounting practice
- low-turnover trader, and
- turnover.

There is also a separate definition of "trading stock" in para (b) of the s YA 1 definition that applies for the following provisions of the Income Tax Act:

- s CG 6 (receipts from insurance, indemnity, or compensation for trading stock)
- s EB 24 (apportionment on disposal of business assets that include trading stock)
- s FB 13 (trading stock — relationship property transfer)
- ss GC 1–GC 3B (disposals below market value).

Trading stock is also further defined in s GC 1 for that section to include an interest in trading stock. See ¶9-087.

A further definition of "trading stock" can also be found in s EZ 48 for the old financial arrangements rules.

Romalpa clauses

Trading stock purchased subject to a Romalpa or reservation of title clause would most probably be trading stock for tax purposes. This is because the definition requires the stock to be "held for the purpose of selling or exchanging in the ordinary course of business". A legal title to, or full ownership of, the stock is not required. Provided the stock is in the person's possession, and the other part of the definition is met, the stock will be trading stock for tax purposes.

Quick reference — defining trading stock

Item	*Satisfies trading stock criteria*	*Reference*
Land	No, but may be revenue account property if it would produce income on disposition.	¶9-008
Leases	Yes, where the right to possess a personal property asset is given in consideration for a lease payment.	¶9-009
Crops	Yes, if severed, eg grapes harvested from the vines. No, if standing crop, eg grapes are still on the vine.	¶9-010
Consumable aids	No, if they are held to be used as part of the manufacturing process without becoming a component part of the finished product.	¶9-011

Quick reference — defining trading stock		
Item	*Satisfies trading stock criteria*	*Reference*
Containers, packages, labels	Yes, these items are incorporated into the final product and are regarded as stock in trade.	¶9-012
Spare parts	Yes, if the spare parts are held for sale or exchange. No, if the parts are held for the maintenance of plant and equipment used for production.	¶9-013
Shares	Yes, if the holder is in the business of trading in shares, ie held on revenue account. No, if the shares are held on capital account.	¶9-060
Work in progress	Yes	¶9-015

¶9-006 Low-turnover traders [IT07 ss EB 13, YA 1]

There is a low compliance cost option for a person when the total of the turnover of the business and the turnover of associated persons for the relevant income year is $3m or less.

The threshold of $3m is a minimum amount which can be increased by Order in Council.

Turnover is the total income derived by a business in an income year from trading (ie sales) excluding the value of closing stock. The focus on income derived by a particular business means that the question of whether a person is a low-turnover trader is to be considered on a business-by-business basis.

Example:

Bill owns two businesses. One is in its first year of operation and has a small turnover of less than $3m. The second business is that of international share trader and has a turnover in excess of $3m. There are no associated persons involved with Bill in respect of either business.

Bill is a low-turnover trader for the purposes of trading stock tax treatment of the new business.

Before concluding that a person is a low-turnover trader, the question of associates must be carefully considered to see whether turnover from their combined business activities tips the $3m threshold. If the threshold is not tipped, all the associated persons are low-turnover traders.

The test of association is that provided for in ss YB 2 and YB 3. Briefly, this means that persons are associated only when companies have at least 50% common ownership or a person has at least 25% ownership of a company.

High-turnover traders

The term ''high-turnover traders'' is not a statutory term but is often used to describe a taxpayer whose turnover (including that of any associated persons) exceeds the $3m threshold in an income year.

¶9-008 Land [IT07 ss EA 2, EB 2(3)(a), YA 1]

Land is excluded from the definition of ''trading stock'' in s EB 2. The definition in this section applies generally for the Income Tax Act 2007, including the trading stock valuation provisions in subpart EB and the matching regime in s EA 2. However, land may be revenue account property.

Special matching rules apply to revenue account property. A deduction for the cost of such property must be allocated to the earlier of the income year in which the property is disposed of and the income year in which the property ceases to exist.

Revenue account property is defined as trading stock or property that would produce income for the person on disposition. Land will be revenue account property if its disposition will give rise to an amount of income, for example, when it is acquired by a dealer or developer. The matching rules in s EA 2 will therefore apply to land when it is revenue account property.

This tax treatment provides a similar result to the approach taken by the courts for matching purposes, which in effect treated land held on revenue account as if it were trading stock, even though the trading stock definition expressly excluded land.

Note also that land whose disposal would produce income under any of the land taxing provisions is expressly included within trading stock for specific provisions of the Act, namely s CG 6 (receipts from insurance, indemnity, or compensation for trading stock), s EB 24 (apportionment on disposal of business assets that include trading stock), s FB 13 (trading stock — relationship property transfer) and ss GC 1–GC 3B (disposals below market value).

Example 1:

Land purchased by a property developer was held to be a purchase of trading stock. While the relevant trading stock provisions did not apply to require the land value to be taken into account at the end of the year, the Taxation Review Authority found that the taxpayer should have shown the value of the land as an asset in its financial accounts. See *Case* M111 (1990) 12 NZTC 2,712.

Example 2:

The above decision was confirmed by the High Court in *Murray Darnill Ltd v Taxation Review Authority (No 2)* (1994) 16 NZTC 11,126. The effect of excluding land from the relevant trading stock provisions was to prevent the trading stock valuation options from being available for land. This meant that land could only be valued in the accounts at cost for tax purposes. The exclusion did not mean that land was to be ignored as trading stock altogether as there were other sections, such as s FB 4 of the Income Tax Act 1994 (concerning disposal of trading stock together with other assets of a business) and s GD 1 of the Income Tax Act 1994 (concerning sale of trading stock for inadequate consideration), which provided that the term ''trading stock'' for their purposes does include land.

Example 3:

The decision in *Murray Darnill* was referred to with approval in *Garwen Holdings Ltd v C of IR* (1995) 17 NZTC 12,396 at p 12,399, where Blanchard J saw no general intention on the part of the Legislature to prevent recognition of a dealer's land as stock-in-trade. To adopt that approach, as advocated by the taxpayer, would create a glaring accounting anomaly. The same issue was further raised in *Thornton Estates Ltd v C of IR* (1998) 18 NZTC 13,577, but it was not necessary for the Court of Appeal to decide the point.

¶9-009 Leases [IT07 ss ED 1, YA 1]

A lease that is not a finance lease is an excepted financial arrangement under the financial arrangements rules. Excepted financial arrangements that are trading stock or revenue account property must be valued at cost unless a nil value can be justified. See ¶9-060.

A lease that is an excepted financial arrangement is, in effect, an agreement under which a lessor transfers to a lessee the right to possess a personal property lease asset in consideration for a personal property lease payment, including a licence to use intangible property, a lease that is two or more consecutive or successive leases that are treated as one lease, a hire or bailment and a sublease.

A hire purchase agreement and an assignment of a hire purchase agreement are excluded from the definition of a lease under s YA 1.

¶9-010 Crops [IT07 s EB 6(1B)]

Vegetables, trees, soil and minerals are regarded by case law as being part of the land and not trading stock until such time as they are severed from the soil. However, this is not explicit in the current trading stock definition.

See *Hood Barrs v Commr of IR (No 2)* (1957) 37 TC 188 (HL), *Saunders (I of T) v Pilcher* [1949] 2 All ER 1097, *Pasley v C of IR* [1958] NZLR 332, *Kauri Timber Co Ltd v C of T* [1913] AC 771 (PC), *Case* T1 (1997) 18 NZTC 8,001.

The decisions in *Kauri Timber Co Ltd v C of T* and *Hood Barrs v Commr of IR (No 2)* may be compared with the decision of the Privy Council in *Mohanlal Hargovind of Jubbulpore v IT Commrs* (1949) AC 521; (1949) 2 All ER 652 (PC). In that case, a firm of cigarette manufacturers entered into short-term contracts with the owners of forests in India to pick and remove the leaves of tendu trees which they used instead of paper in making cigarettes. It was held that the taxpayers were merely given a right to pick and carry away the leaves and not an interest in land or in the trees or plants themselves.

Their Lordships said that in a business sense the expenditure was:

> expenditure on revenue account and not on capital account just as much as if the tendu leaves had been bought in a shop. Under the contracts it is the tendu leaves and nothing but the tendu leaves that are acquired.

Their Lordships distinguished *Kauri Timber Co Ltd v C of T* and pointed out that in the present case the trees were not acquired, nor were the leaves acquired, until the taxpayers had reduced them into their own possession and ownership by picking them and that the two cases were not comparable.

Therefore, the circumstances of each case must be carefully considered to determine whether what is purchased is:

- an interest in land
- primarily a right that will provide the purchaser with trading stock, or
- primarily a purchase of goods with an ancillary right to obtain possession of those goods.

With the adoption of International Financial Reporting Standards, the fair value method in NZIAS 41 *Agriculture*, instead of NZIAS 2 *Inventories*, may be required to be used to value harvested trading stock. Taxpayers that adopt NZIAS 41 must value their trading stock at cost. See s EB 6(1B).

¶9-011 Consumable aids

[IT07 ss EA 3, EB 2(3)(a)]

Although the definition of trading stock includes "materials that the person has for use in producing trading stock", there is a specific exclusion for "consumable aids to be used in the process of producing trading stock". Consumable aids are not defined for tax purposes but are, broadly, items that are used up in the manufacturing process without becoming a component part of the finished product. For example, the consumable aids of a steel manufacturer might include coal or oil stocks, for the commerce industry, computer paper or stationery and for a farmer, stocks of hay, feed, and fertiliser.

Example 1:

Chemicals, cleaning fluids and various other articles used in manufacture were consumable aids and not trading stock on the basis that they would not become component parts of finished products and were not goods "purchased for purposes of manufacture". See *Case* 115 (1951) 1 TBRD at 573.

In addition, at p 571, the Chairman of the Board stressed the temporary life of the aid goods:

> Their nature and functions are such that nearly all of them would be used up, or become unusable and worthless, as the result of being applied once in the manufacturing process and that the others, although capable of a limited repetitive use, have a very short life.

Example 2:

Grinding wheels having a life of 9–24 days and furnace bricks having a life of approximately 21/2 weeks were consumable aids and not trading stock. See *Case* 16 (1968) 4 NZTBR. See also *Case* E98 (1987) 9 NZTC 59,522.

The tax treatment of consumables differs from the relevant accounting treatment set out in NZIAS 2 *Inventories*.

Purchases of consumable aids are normally allowed as a deduction under the general permission although the timing of the deduction is governed by s EA 3. The timing for a deduction of such expenditure depends on whether the value of stocks of consumable aids exceed $58,000. If the value is under $58,000, the expenditure incurred in purchasing the consumable aids is claimed in full as a deduction. Effectively, the value of any unconsumed stock of consumable aids at the end of the income year is not required in calculating assessable income provided it has not been capitalised for financial reporting purposes. If stocks exceed $58,000 at balance date, the whole value of these stocks is capitalised as either deferred or prepaid expenditure, or as stocks of consumable aids, ie the unexpired portions of expenditure are added back to income. See *Determination* E12 and ¶10-056.

Example 3:

Bigfoot Shoes Ltd purchases 50,000 litres of solvent at a cost of $100,000 during the 20X2/X3 income year. The solvent is for use in shoe manufacturing. At the end of the income year drums containing 30,000 litres of solvent (with a cost of $60,000) remain unopened.

The entire cost of the solvent is allowed as a deduction in the 20X2/X3 income year as expenditure on a consumable aid. However, because the unexpired portion of the solvent is $60,000, and therefore greater than $58,000, the unexpired portion of $60,000 must be included as income in the 20X2/X3 income year.

The $60,000 becomes deductible in the 20X3/X4 income year but, if the timing rule for prepayments applies again in that year, further income will be derived on the unexpired portion.

Under the trading stock rules, consumable aids form part of the costs allocated by persons valuing closing stock at cost. They represent a part of the cost of putting the trading stock in its present location and condition. See ¶9-025. However, consumable aids are excluded from the definition of trading stock for tax purposes. What this means in practice is that persons who comply with NZIAS 2 *Inventories* for financial reporting purposes must include the cost of consumable aids as income for tax purposes under s EA 3 regardless of the amount held at the end of the year. *Determination* E12 will not apply as the cost of the consumable aids has been capitalised for financial reporting purposes. See example 3 in *Tax Information Bulletin* Vol 10, No 12, December 1998 at 25–26.

If the costs of consumable aids have previously been claimed as a deduction, any insurance proceeds subsequently received for lost or damaged consumable aids will be income.

▶ ***Note:*** In December 2013, the Commissioner released draft interpretation statement INS0123, "Income tax — consumable aids", for comment. The draft statement updates and replaces an item on consumable aids published in the *Tax Information Bulletin* in 1995 and an earlier item published in the *Public Information Bulletin* in 1969. The draft statement outlines what a consumable aid is, how the expenditure on consumable aids is deductible, when expenditure on consumable aids needs to be added back under s EA 3 and how *Determination* E12 applies to consumable aids.

¶9-012 Containers, packages, labels

[IT07 s EB 2(2)(b)]

In contrast to consumable aids, containers, packages, labels and similar materials are incorporated in the final product and are regarded as stock in trade. See *Case* 115 (1951) 1 TBRD.

This would appear to be confirmed by s EB 2(2)(b). This provision refers to material held by the person for use in producing trading stock.

¶9-013 Spare parts

[IT07 ss EA 3, EB 2(2), (3)(h)]

Spare parts may be held for two purposes:

- as replacement elements for items of trading stock, or
- for the maintenance of plant and equipment.

Chapter 21 FRINGE BENEFIT TAX

¶21-010 Background — [IT07 ss CX 2, CX 3, DB 1, RA 5(1)(b)]

Fringe benefit tax (FBT) is a tax payable on the value of fringe benefits provided to employees by an employer.

Fringe benefits are excluded income of the employee.

The reason an employer, rather than an employee, is taxed is to encourage a shift in remuneration paid in cash rather than a payment in kind. It also helps to ease administration, as it is easier to assess one employer rather than a multitude of employees. The Government introduced FBT primarily to widen the tax base, supply more revenue, improve equity (by ensuring non-cash benefits provided to employees were subject to tax) and improve resource allocation. An employer is taxed on all benefits provided to:

- employees — this applies to benefits provided or granted in relation to past, present or future employment by the employer (the concept of employment is therefore very wide), and
- shareholder-employees.

The cost of providing a fringe benefit is deductible only if it meets the general permission and none of the general limitations apply. FBT itself is also deductible on this basis and is excluded from being a non-deductible ancillary tax by s DB 1. FBT is deductible in the income year the fringe benefit was provided or granted, even though the tax may not be due and payable in that year. The tax is imposed on a quarterly, annual or income-year basis on the value of the fringe benefits provided by the employer during that period, with payment due by a specified date after the end of the period. See ¶21-030. Situations where a benefit is deemed to be provided or granted are extremely wide, bearing in mind the definitions of ''employee'' and ''employer''. Employers are liable for FBT if an employee receives a benefit from them or some other person under an arrangement with them.

The FBT rate was increased from 1 April 2000 to prevent high-income earners avoiding the top personal tax rate by substituting fringe benefits for salary or wages. Because of the increased FBT rate, employers providing fringe benefits to employees earning less than the top tax bracket threshold per annum were over-taxed. Accordingly, the multi-rate FBT option (later renamed the alternate rate option) was introduced. Since its introduction there have been

changes to the personal tax rates and consequently changes to FBT rates. Currently this system generally allows employers to choose to pay FBT for the 2013/14 tax year either at 49.25% or at a rate based on the remuneration paid to the employee. See ¶21-161–¶21-164.

FRINGE BENEFIT TAX GENERALLY

¶21-020 Goods and services tax — [IT07 ss DB 2(2), RD 33(4), RD 37(2), RD 40(3), RD 41(4), YA 1; GST ss 10(7), 21I(1)–(3), 23A]

The supply of a fringe benefit is deemed to be a supply of goods and services, so a GST-registered employer is generally liable for GST output tax on fringe benefits provided to employees. There is no deemed supply for GST purposes if:

- the employee paid an amount for the receipt or enjoyment of the fringe benefit
- the fringe benefit arose by virtue of an exempt supply
- the fringe benefit arose by virtue of a zero-rated supply, or
- the fringe benefit is, or is deemed to be, provided or granted by a registered person in the course of making exempt supplies.

The time of supply is the time at which the fringe benefit is (or is deemed to be) provided or granted. See s 21I(1)–(3) of the Goods and Services Tax Act 1985.

GST-registered employers must include and pay the GST on fringe benefits with their FBT [illegible]. This GST payment is treated as a payment of FBT for the purposes of filing the FBT [illegible] and Pts 4A (disputes procedures), 6 (assessments), 7 (interest), 9 (penalties), 10 (recoveries) and 11 (remission, relief, and refunds) of the Tax Administration Act 1994.

The consideration for the supply of a fringe benefit for GST purposes is deemed to be the taxable value of the fringe benefit, as determined under the FBT rules in the Income Tax Act 2007. The taxable value of a fringe benefit under the FBT rules is inclusive of GST if the GST-registered employer can claim an input tax credit for the benefit provided. Low-interest loans and the provision of accommodation are exempt from GST, so the FBT value of such items is GST-exclusive.

The provisions applying to subsidised transport, superannuation scheme contributions and goods and services stipulate that FBT is calculated on a GST-inclusive basis.

GST on fringe benefits is deductible for income tax purposes to the extent that the person is allowed a deduction for expenditure incurred in acquiring or producing the goods or services or they are allowed a deduction for an amount of depreciation loss for the goods or services.

¶21-025 Form of fringe benefit — [IT07 s CX 2(1)(b)]

A fringe benefit may take the form of:

- making available to an employee a motor vehicle for private use
- an employment-related loan (including loans by a life insurer to a policyholder)
- subsidised transport
- contributions to a sickness, accident or death benefit fund
- contributions to funeral trusts
- any specified insurance premium
- contributions to any insurance fund of a friendly society

- any contribution to any superannuation scheme
- any allowance paid in respect of a member of Parliament's travel, accommodation, attendance or communications services to the extent that such services are exempt from tax, or
- any benefit of any other kind received by an employee.

Certain benefits are excluded from FBT. See paragraphs beginning ¶21-555.

Meaning of benefit

Inland Revenue has released "Questions we've been asked" item, "The Meaning of 'Benefit' for FBT Purposes". Briefly, the item states:

- an employee does not need to have made a profit for a "benefit" to have been provided for FBT purposes
- a "benefit" means what is received by an employee, without regard to any contribution made by the employee
- a benefit is provided "in connection with the employment relationship" if the employment relationship is the reason for, or at least a substantial reason for, the provision of the benefit
- whether a benefit for which market value is paid by an employee is "in connection with" an employment relationship depends on the facts in each case
- whether a fringe benefit is provided does not depend on whether employees consider that they have received an advantage or benefit.

The item is published in *Tax Information Bulletin* Vol 18, No 2, March 2006 at 26.

¶21-030 Collection and returns [IT07 ss RA 15, RD 60–RD 62; TAA ss 4

Payment on quarterly basis

Every employer who provides a fringe benefit and pays FBT on a quarterly basis must file an FBT return within 20 days from the end of each quarter showing:

- details of the benefits received or enjoyed by each of the employer's employees in a quarter, and
- a calculation of the FBT payable on the taxable value of the fringe benefits.

FBT is payable on 20 July, 20 October and 20 January, for the three-month periods (or quarters) ending 30 June, 30 September and 31 December respectively. FBT for the quarter ended 31 March is payable on the 31 May following the end of that quarter. For example, the FBT return and any FBT payable for the quarter ended 31 March 2014 is due and payable on or before 31 May 2014.

If an employer stops employing staff and does not intend to replace them during the year, the final FBT return and any associated FBT payable are due at the end of two months immediately following the end of the quarter in which the employer stops employing staff. For example, if an employer ceases to employ staff on 25 July 2014 (September 2014 quarter), the final FBT return and FBT payable are due on or before 30 November 2014.

A return is required on the above due dates, even if the employer has not provided or granted any fringe benefits during the relevant quarter.

However, the Commissioner may exempt employers from the need to file nil returns. Inland Revenue's (IR) "Fringe benefit tax guide", IR 409, November 2011, states that employers who do not provide or do not intend to provide fringe benefits may apply for "nil status".

Further, employers who have provided fringe benefits in any of the first three quarters but have since ceased to provide fringe benefits must file quarterly returns up to and including the fourth quarter. "Nil status" will apply after the fourth quarter. See pp 9–10 of the IR guide.

Employers that no longer intend to provide fringe benefits to their employees may be advised to file a "fringe benefit tax election" so that their intention to become a nil filer is triggered and recorded within IR's system. This form can be completed and sent electronically through the "Online Services" pages of IR's website at www.ird.govt.nz.

Payment on an income-year and annual basis

An employer can elect to pay FBT in respect of employees on an annual basis where the employer is a small business (see ¶21-145) or on an income-year basis where the employer is a close company and a small business providing benefits to shareholder-employees (see ¶21-150). Where an FBT return is made under the small business option, the return must be filed and the FBT paid by 31 May following the end of the relevant income year. If the employer has elected to pay FBT under the close company option, the employer will be liable to pay the total amount to the Commissioner no later than the terminal tax date of the employer for that income year.

Change in periods

If an employer who accounts for FBT under the close company option or the small business option fails to meet the relevant criteria for the use of those options, the employer must revert back to accounting for FBT on a quarterly basis (under the single rate option or the alternate option) from the beginning of the first day of the income year.

An employer who accounts for FBT on either of the above bases may at any time elect by notice in writing to pay FBT on a quarterly basis. Where an employer with an approved alternative balance date elects to change from a quarterly basis of accounting for FBT, transitional provisions will apply to the period between the last quarter payment and the first day of the income year. That period will be treated as if it were a separate quarter and FBT will be paid accordingly.

Returns online

FBT returns may be filed online with IR using eFBT. Filing online is optional. Employers who choose to use this service must keep the paper return sent to them as they will need the unique 14-digit number printed at the top of the return. Some of the FBT calculations will also be done automatically if returns are filed online.

¶21-040 Late payment penalties [TAA s 139B]

Any amount of FBT not paid by the due date attracts an initial penalty of 5%. This penalty is charged incrementally. A penalty of 1% is applied the day after the due date for unpaid tax and 4% is applied seven days after the due date. An incremental monthly penalty of 1% applies on the amount of FBT outstanding, plus the initial late payment penalties, for each successive month until payment. Such late payment penalties are not deductible for income tax purposes. See s DB 1(1).

Taxpayers are notified the first time they make a late payment of tax. The late payment penalty will then only be imposed if the payment is not made within one month after the date of the notice. However, if the taxpayer makes other late payments within two years of the due date of the first late payment, the late payment penalty will be imposed as usual from the day after the due date.

The late filing penalty imposed by s 139A of the Tax Administration Act 1994 does not apply to FBT returns.

¶21-050 FBT assessed by Commissioner [TAA s 93]

The Commissioner may make an assessment of the amount of FBT in respect of any quarter or any income year to be paid by any person chargeable with the tax. That person is then liable for the tax assessed unless the person establishes otherwise in proceedings challenging the assessment. This procedure may be used by the Commissioner if, for example, an employer fails to make a return or the Commissioner is dissatisfied with the return. The assessment procedure is the same as for income tax.

¶21-060 Deductibility of FBT [IT07 s EF 1]

FBT is deductible in the income year in which the employer provides or grants the benefit that gives rise to the tax. This will not necessarily be the same tax year as the tax year in which the employer pays FBT. See ¶10-292.

Employers with a non-standard balance date who pay FBT on a quarterly basis will find that they may have an FBT quarter that spans two tax years. In this case, the Commissioner's policy is that the FBT on benefits provided by the employer before the end of the earlier tax year is deductible in that earlier year and benefits provided in the later tax year are deductible in that year. Employers who pay FBT on an annual or income-year basis will deduct FBT in the tax year in which the employer provides the benefit to which the FBT relates (even if the FBT is not paid on that benefit until the next tax year). See *Tax Information Bulletin* Vol 6, No 13, May 1995 at 10. Deductibility of FBT means that the effective rate of tax is 33% (assuming FBT is paid at 49.25%) for taxpayers.

¶21-070 Employment relationship [IT07 ss CX 2, RD 25(2), YA 1]

For a benefit to fall within the FBT provisions, it must be provided by an "employer" to an "employee" in connection with the employee's "employment" (past, present or future).

"Employment" has a meaning corresponding to the meaning of "employee" and encompasses all activities carried on by an employee. An "employee" is person who receives or is entitled to receive a PAYE income payment and an "employer" is a person who pays or is liable to pay a PAYE income payment. A "PAYE income payment" is a payment by way of salary, wages, an extra pay (bonuses, etc) or schedular payments (eg directors' fees or payments to a commission agent or salesperson). See s RD 3(1) and ¶3-012.

Excluded PAYE income payments

Certain types of PAYE income payments do not give rise to an employment relationship for fringe benefit purposes. These are payments to a working partner that are deductible by virtue of s DC 4, payments to working owners that are deductible under s DC 3B, income-tested benefits, veterans' pensions, New Zealand superannuation, parental leave payments, any basic grant or independent circumstances grant made under s 193 of the Education Act 1964 or s 303 of the Education Act 1989, certain accident compensation earnings-related payments, and schedular payments referred to in sch 4, pt A and pt I. See para (c) of the definition of "employee" in s YA 1.

¶21-080 Employer defined [IT07 s YA 1]

An "employer" is any person who pays or is liable to pay (whether in the past, present or future) a PAYE income payment apart from those PAYE income payments that are specifically excluded (see ¶21-070 under the heading "Excluded PAYE income payments"). The definition of "employer" also includes each partner in the case of a partnership, a look-through company (unless the owner is a working owner), the manager (or principal officer) in the case of an unincorporated body of persons, a trustee or company liquidator (ie when property is controlled or vested in a fiduciary capacity) and the Crown when it provides taxable benefits to any employee.

¶21-090 Employee defined [IT07 s YA 1]

An "employee" is any person who receives or is entitled to receive (whether in the past, present or future) a PAYE income payment apart from PAYE income payments that are specifically excluded (see ¶21-070 under the heading "Excluded PAYE income payments"). This definition allows FBT to be levied on benefits arising at the time an employee derives no PAYE income payments, but relates to a time when PAYE income payments were made. For example, if a retired bus driver is given a free bus pass, that pass is a fringe benefit that arises by virtue of past employment and FBT is payable. The definition also includes some self-employed taxpayers who may not regard themselves as employees.

Example 1:

Fast Eddie works as a sales agent for a company as an independent contractor. He is paid on commission. The company provides him with unrestricted use of a car and a cellphone. Fast Eddie is an employee for FBT purposes because he receives PAYE income payments in the form of schedular payments. See ¶21-070.

Example 2:

A taxpayer company paid directors' fees to its directors. The directors were, therefore, employees for FBT purposes and received a fringe benefit when they received low-interest loans. See *Roma Properties Ltd v C of IR* (1998) 18 NZTC 13,903 (CA).

A shareholder-employee of a close company may elect to opt out of the PAYE rules in relation to drawings taken from the company in anticipation of a salary being subsequently declared. From 1 April 2008, such a shareholder-employee is subject to the FBT rules (with the exception of a person who adopted a different tax position for the period up to 30 November 2010).

¶21-100 Benefits provided by another party [IT07 ss CX 2(2), (5), GB 31, YA 1]

When a benefit is provided by some other person under an "arrangement" with an employer, the employer is treated as having provided the benefit, and liability for FBT arises accordingly (s CX 2(2)). "Arrangement" means a contract, agreement, plan or understanding (whether or not enforceable) and all steps and transactions by which it is carried into effect. An example would be when benefits are provided by a parent company to employees of a subsidiary. In this case, the subsidiary employer company would be regarded as providing the benefit and would be liable for FBT.

In addition, s CX 2(5) provides that a benefit may be treated as being provided by an employer to an employee under s GB 31, which deals with a tax avoidance arrangement (see below), and under s GB 32, which deals with a benefit being provided to an associate of an employee (see ¶21-110).

In public binding ruling BR Pub 09/07, Inland Revenue states that s CX 2(2) of the Income Tax Act 2007 will apply in the following situations:

- consideration passes from the employer to the third party in respect of the benefit being provided
- the employer requests (other than merely initiating contact), instructs or directs the third party to provide a benefit

- there is negotiation or discussion between the employer and the third party that (explicitly or implicitly) involves the threat or suggestion that the employer would withhold business or other benefits from the third party unless a benefit is provided to the employees, or
- the third party and the employer are associated parties and there is a group policy (whether formal or informal) or any other agreement between the associated parties that employees of the group will be entitled to receive benefits from the other companies in the group.

The ruling also provides that s CX 2(2) will not apply where:

- there is negotiation or discussion between the employer and the third party that results in no more than:
  - ☐ the employer granting the third party access to the premises or work environment to discuss the benefit with employees, and/or
  - ☐ agreement between the parties as to the level of benefit that is to be offered by the third party to employees, and/or
  - ☐ the employer agreeing to advertise or make known the availability of the benefit
- the employer has done no more than initiate contact or discussions with the third party, or
- there is no significant contact between the employer and the third party.

The ruling does not apply to arrangements where the remuneration given by an employer to an employee is reduced because a benefit is being received from the third party, or otherwise takes the receipt of a benefit provided by a third party into account (including salary sacrifice situations). There cannot be any trade-off between the benefits provided and the remuneration that would otherwise have been received by the employee, nor can there be any difference between the remuneration levels of employees who receive benefits and those who do not.

Public binding ruling BR Pub 09/07 applies for the period beginning on the first day of the 2008/09 income year and ends on the last day of the 2013/14 income year.

An arrangement under which persons attempt to alter their relationship so that there is no employment involved is countered by s GB 31. This section can apply when avoidance is only one of the purposes of the arrangement, so long as avoidance is not merely an incidental purpose. When taxpayers are involved in an FBT avoidance arrangement, the Commissioner can treat:

- a party to the arrangement as the employer
- the recipient of the benefit as the employee, and
- the benefit being passed from the deemed employer to the deemed employee (or what would have been the benefit had the arrangement not been entered into) as being provided by virtue of the employment of the deemed employee.

FBT will apply accordingly throughout the period(s) during which the arrangement is in force.

See also ¶21-120.

¶21-105 Fringe benefits provided to shareholder-employees or group investment fund investors [IT07 ss CD 20, CX 17(1), (3), DG 2(4)]

Any non-cash benefit provided or granted by a corporate employer to a shareholder-employee is treated as having been received by that shareholder-employee in his or her capacity as an employee unless the company elects to treat the benefit as a dividend (see below). If the company does not elect for the benefit to be treated as a dividend, the FBT rules apply.

In similar terms, where a non-cash benefit is granted by the trustee of a group investment fund to an employee and investor in the fund, the benefit is treated as having been received by the employee and investor in his or her capacity as an employee unless the trustee of the group investment fund elects to treat the benefit as a dividend.

An exception applies in respect of non-executive company directors. In such a case, any non-cash benefit (which would otherwise be subject to FBT) is treated as having been derived in that employee's capacity as a shareholder of the company and, as such, is taxable to that person as a dividend. See ss CD 20(2), CX 17(3) and ¶16-585.

A company or trustee of a group investment fund that provides a non-cash benefit, to an employee who holds shares in the company or who is an investor in the fund, may elect to treat the benefit as a fringe benefit or a dividend if the following criteria are satisfied.

The benefit would:

- if not for s CD 32, be a dividend under s CD 4 if provided to the person in their capacity as a shareholder, and
- if not for s CX 4, be an unclassified benefit if it was provided to the person in their capacity as an employee.

Where the company or trustee elects to treat the benefit as a fringe benefit they must give notice to Inland Revenue of their election within the time allowed for filing an FBT return for the period in which the benefit was provided. See s CX 17(5). In this situation the FBT rules will not apply.

If the company or trustee makes no election, the benefit is treated as a fringe benefit.

There is no option to elect in respect of benefits provided to non-executive directors.

Where the non-cash benefit provided to a shareholder in a company is subject to the mixed-use asset rules (see ¶10-032) the company must elect to treat the benefit as a dividend.

¶21-110 Benefit to associated person of employee [IT07 ss CX 18, GB 32]

Section GB 32 provides that where a fringe benefit is provided by an employer to a person associated with the employee, the employee is treated as receiving the fringe benefit. There are two exceptions to this general rule. The first is where benefits are provided by a company to corporate associates of shareholder-employees. Where the benefit is not provided under an arrangement that has a purpose of providing the benefit in lieu of employment income or free from FBT, the benefit will not be subject to FBT, although it may be subject to the dividend regime.

The second exception is when benefits are provided by look-through companies, partnerships or limited partnerships and the person associated with the employee is an owner of the look-through company or a partner in the partnership or limited partnership.

An intention of both the FBT rules and the dividend rules is to tax non-cash benefits when derived by associated persons. Conflicts arise when a person (other than a company) receives a non-cash benefit from a company and that person is not only associated with an employee of that company but is also associated with a shareholder of that company.

distribution. However, s MB 5 does not apply to a person receiving a distribution on or after his or her retirement if the employer contributed to the superannuation scheme if it is a KiwiSaver scheme or complying superannuation fund. As a result, an employee cannot reduce his or her income to a level whereby the employee would qualify for a family scheme tax credit.

¶29-440 Low-interest loans to members

Up until 1 April 2011, where a superannuation scheme has made a loan to a member on concessional terms, the value of the loan was deemed to be income of the scheme. This value is calculated using the difference between the prescribed interest rate for fringe benefit tax purposes and the actual interest rate of the loan. This value was excluded from the definition of fringe benefit to avoid double tax.

¶29-445 Employee benefit funds [IT07 s DC 6]

Some employers operate funds (not being superannuation schemes) designed to provide individual personal benefits to their employees. Such funds often take the form of welfare funds which make up the salary of employees who are absent from work for health reasons. Many such funds assist employees to meet the costs of medical, dental and optical services. The Commissioner has complete discretion to allow as a deduction the whole or any part of an employer's contributions to such benefit funds. No deduction is allowed unless the Commissioner is satisfied that the fund has been established or the payment has been made in a manner which fully secures the rights of employees to receive the benefits. An employer who wishes to obtain a deduction should send full details to the Commissioner, outlining the benefits to be provided for the employees and the means adopted to secure the rights of the employees to those benefits.

Chapter 30 DUTY

¶30-010 Background

A duty may generally be seen as a tax on capital, rather than income, because it is commonly fixed by reference to the principal amounts involved. In addition to providing a significant means of revenue for the Government, there is often a social policy intent behind duties legislation. Estate duty, for example, was introduced as a means for preventing the accumulation of wealth in the hands of those who had not earned it. The original purpose of gift duty was to protect estate duty. However, it was overtaken by other developments and is now obsolete.

The assessment and collection of duties is administered by Inland Revenue (IR). Cheque duty is imposed on bills of exchange under the Stamp and Cheque Duties Act 1971. Duty is also imposed on the winnings of gaming and casino operators, lottery organisers and race clubs under the Gaming Duties Act 1971.

GIFT DUTY

¶30-125 Gift duty abolished from 1 October 2011

Gift duty has been abolished for dispositions of property made on or after 1 October 2011. The Estate and Gift Duties Act 1968 remains effective with respect to dispositions of property before this date.

Key features are as follows:

- Gift duty will not be payable and gift statements will not have to be filed for dispositions of property made on or after 1 October 2011.
- Gift duty and gift statements will remain due for dispositions of property made before 1 October 2011.

If a gift of property which is in New Zealand is made before 1 October 2011, it is liable for gift duty. In addition, a gift of property which is outside New Zealand is liable for gift duty if the giver's permanent home is in New Zealand, or the giver is a company incorporated in New Zealand. See Inland Revenue (IR) booklet "Gift duty" (IR 195 — March 2012) for more details.

Gift duty had existed in New Zealand since 1885. Its original purpose was to protect the estate duty base by discouraging the gifting of assets before death and to raise revenue. Estate duty was abolished in New Zealand in 1992. At that time, it was decided that gift duty would be retained temporarily until concerns regarding income tax avoidance and social assistance targeting could be addressed.

On 4 October 2010, a regulatory impact statement was produced by IR officials dealing with the potential repeal of gift duty. The statement provided an analysis of the tax and non-tax benefits and administrative and compliance costs of gift duty. It was considered that gift duty no longer raised any significant revenue and imposed a high level of compliance costs on the private sector. In addition, the protections offered by gift duty in the areas of income tax, creditors and social assistance had only ever been incidental rather than intended policy goals. The analysis undertaken had shown that the protection gift duty offered was indirect, inefficient and very limited. It was therefore recommended that gift duty should be repealed.

As a result, gift duty was repealed from 1 October 2011.

¶30-126 Issues arising from the abolition of gift duty

With the abolition of gift duty, the making of a gift has become more flexible. However, a gift can give rise to a number of issues which can result in adverse consequences for the donor. Before a gift is made, consideration should be given to the following issues:

- income tax implications
- financial arrangements rules
- creditor protection
- relationship property
- residential care subsidies
- documentation, and
- laws in foreign jurisdictions.

The following income tax and GST implications arising from the abolition of gift duty should be considered:

- The abolition of gift duty does not have any impact on the income tax anti-avoidance rules. As has always been the case, a gift may be deemed to be part of a wider arrangement of tax avoidance under s BG 1 of the Income Tax Act 2007.
- When a gift is made, a specific rule in the Income Tax Act deems there to be a disposal and acquisition at market value. As a result, the gifting of tax base property may give rise to income tax implications such as depreciation recovery income.
- The gifting of shares can give rise to a breach in shareholder continuity for the purposes of carry forward losses and imputation credits.
- Section 10(3) of the Goods and Services Tax Act 1985 treats the associated supply of goods and services as if they were for market value where there is no fully adequate consideration. Therefore, the provision of goods and services as gifts may give rise to GST consequences where the donor is GST registered.

Financial arrangements rules

The debt that arises from the sale and debt-back mechanism adopted to avoid gift duty is a financial arrangement.

A loan that is interest-free and repayable upon demand is an excepted financial arrangement to the lender. This means that no income accrues to the lender from the arrangement: see s EW 5(10).

However, from the borrower's perspective, a loan is subject to the financial arrangements rules. Where a debt is forgiven, the rules that apply to financial arrangements provide that income can accrue to the trustee borrower. However, these rules do not apply where the debt is forgiven in consideration of natural love and affection. Where the debtor is a trustee, natural persons are able to forgive debts owed to them by the trustee without income tax consequences if the trust was established mainly to benefit "a natural person for whom the creditor has a natural love and affection" and/or a charity that is registered with the Charities Commission: see s EW 50.

Where, however, trustee debts have been forgiven, and the trustees of the trust subsequently make distributions to persons other than those for whom the creditor has natural love and affection or registered charities, such distributions will be income to the trustees in the year in which the distributions are made to the extent that the distributions do not exceed the amounts of the debts forgiven: see s EW 50.

Following the abolition of gift duty the limitations on beneficiaries that previously applied to avoid financial arrangement income will no longer apply. This means that if assets are gifted directly to trustees of a trust where no gifting programme has been in place there is no requirement to limit the classes of beneficiaries as has been the case.

Creditor protection

Before a gift is made, the solvency of the donor should be considered. This is because there are two main pieces of legislation which provide protection to creditors and may cause gifts to be clawed back in certain circumstances.

Section 346 of the Property Law Act 2007 contains provisions which allow for gifts to be clawed back where a creditor has been prejudiced. In particular, it applies to dispositions made after 31 December 2007 by a debtor with intent to prejudice creditors, or made by way of gift without receiving reasonably equivalent value in exchange in the following circumstances:

- the debtor (donor) was insolvent at the time, or became insolvent as a result, of making the disposition
- the debtor was engaged, or was about to engage, in a business or transaction for which the remaining assets of the debtor were, given the nature of the business or transaction, unreasonably small, or
- the debtor intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay.

Subpart 6 of Pt 6 of the Property Law Act empowers the courts to set aside property dispositions where there was an intention to prejudice the interests of a creditor-applicant.

The Insolvency Act 2006 applies where a donor has become bankrupt. Any gift made by the donor within the two years before the bankruptcy can be cancelled by the Official Assignee: see s 204. In addition, gifts made between two and five years prior to bankruptcy can also be set aside if the bankrupt was unable to pay his or her debts: see s 205. The onus is on the bankrupt to prove solvency without the aid of the property gifted.

Section 292 of the Companies Act 1993 gives the Official Assignee similar powers but over shorter time frames (six months and two years).

Relationship property

With the abolition of gift duty, it will become easier for a person to transfer property into trusts to defeat the interests of his or her spouse. However, a spouse may be entitled to compensation under the Property (Relationships) Act 1976 where his or her claim has been defeated by the disposition of property. Under the Act, the court can make an order for a person who has received the property otherwise than in good faith to transfer the property to any person that the court directs or to pay the difference between the value of the property and the consideration paid (if any): see s 44.

Any significant gifts of relationship property should be recorded in a s 21 of the Property (Relationships) Act agreement if the gift is being made in fulfilment of relationship property rights.

The possibility of claims under the Family Proceedings Act 1980 should also be taken into account.

Residential care subsidy

Entitlement to the residential care subsidy is determined in accordance with the Social Security Act 1964 and the Social Security (Long-term Residential Care) Regulations 2005. The legislation is administered by Work and Income New Zealand (WINZ), the service delivery arm of the Ministry of Social Development.

Regulation 8 defines a gifting period that commences five years before the date of the means assessment.

The Social Security Act has means-testing provisions for both assets and income. Section 147A states that where a person (or the person's spouse or partner) applies for a means assessment, and that person has "directly or indirectly deprived himself or herself of any income or property", the chief executive has a discretion to assess the person as if the deprivation has not occurred. Deprivation of property includes:

- gifts in excess of $6,000 per year in the five-year period before application for a residential care subsidy, and
- any gifts that exceed $27,000 in any 12-month period before the five-year period.

Regulation 9B lists instances that qualify as deprivation of assets in accordance with s 147A of the Social Security Act. There is no time limit on the Ministry of Social Development's discretion to consider adding back assets that applicants have divested prior to the commencement of the five-year gifting period (unlike the five-year clawback on "allowable gifts" of up to $6,000: see reg 9).

A Court of Appeal decision means that gifting by a person's spouse can be taken into account when assessing that person's entitlement to residential care subsidies (*Bridgford v Chief Executive of the Ministry of Social Development* [2013] NZCA 310). In that case a wife and her husband had set up a family trust in 1987 and made gifts of $27,000 each per year between 1987 and 2004. In 2009, the wife moved into a rest-home and her application for a residential care subsidy was declined due to her assets considerably exceeding the limit for eligibility. All gifts made by the wife and her husband collectively in excess of $27,000 per year were counted back as personal assets. The Court of Appeal found that for the purpose of the exemption for gifts in the Social Security Act 1964, the exemption was limited to a combined sum for both the applicant and their spouse or partner of $27,000 per annum.

Because the regulations focus on deprivation of assets by the applicant, it does not matter that these assets have changed legal ownership. There is no need to look behind a trust or to show that the applicant has retained the effective control or enjoyment of the transferred assets. Simply the fact that the applicant has transferred his or her assets may allow them to be brought back into means testing.

Documentation

Proper documentation should still be kept to record the nature of gifts made, regardless of the fact that gift statements will no longer be required to be filed from 1 October 2011. Gifts should be recorded in a deed of gift. The reasons for making the gift should also be documented, given that the clawback provisions outlined above will become more prevalent.

Trustees will still be required to keep a record of all forgiveness of debt and distributions to beneficiaries over the life of the trust: s 22B of the Tax Administration Act 1994.

Laws in foreign jurisdictions

Although gift duty will not be an issue from a New Zealand perspective, gifting laws in foreign jurisdictions should be considered where the donor is also subject to the laws of a foreign jurisdiction.

¶30-130 Disposition of property made before 1 October 2011 [EGD ss 2(2), 61–65]

For commentary on dispositions of property made before 1 October 2011 please refer to CCH, *New Zealand Master Tax Guide 2013*.

¶30-135 Exemptions from gift duty for disposition of property made before 1 October 2011 [EGD ss 71–75C]

Gifts valued at $27,000 or less and made in a 12-month period are subject to a "nil" duty rate. For commentary on exemptions from gift duty for dispositions of property made before 1 October 2011 please refer to CCH, *New Zealand Master Tax Guide 2013*.

¶30-140 Valuation of dutiable gift applying to a disposition of property made before 1 October 2011 [EGD ss 66–70]

For commentary on the valuation of dutiable gifts applying to a disposition of property made before 1 October 2011 please refer to CCH, *New Zealand Master Tax Guide 2013*.

¶30-145 Leases for life, life interests and licences to occupy [EGD ss 2(2), 70, sch 2]

For commentary on the tax implications applying to asset-planning transactions involving leases for life, life interests or life estates please refer to CCH, *New Zealand Master Tax Guide 2012*.

¶30-150 Calculation of gift duty for disposition of property made before 1 October 2011 [EGD ss 62, 76, 77, sch 3]

Gift duty is payable at progressive rates according to the value of dutiable gifts made by the donor within a 12-month period. For commentary on the calculation of gift duty for dispositions of property made before 1 October 2011 please refer to CCH, *New Zealand Master Tax Guide 2013*.

¶30-160 Payment of gift duty for dispositions of property prior to 1 October 2011 [EGD ss 62, 79–82, 85–87]

For commentary on the payment of gift duty for dispositions of property prior to 1 October 2011 please refer to CCH, *New Zealand Master Tax Guide 2013*.

¶30-165 Penalties applying to gift duty on dispositions of property made before 1 October 2011 [EGD ss 83, 95]

A penalty on gift duty is payable if the gift duty is not paid within six months of the making of the dutiable gift. A late payment penalty of 5% followed by a monthly incremental 1% charge applies to all donors who have not paid by that date.

For further information regarding penalties on gift duty please refer to CCH, *New Zealand Master Tax Guide 2012*.

CHEQUE DUTY

¶30-270 Cheque duty [SCD ss 77, 78, 81, 84]

Bills of exchange are liable to cheque duty unless a specific provision exists to exempt a particular bill from the duty. See s 77 of the Stamp and Cheque Duties Act 1971.

A bank is required to forward to the Commissioner, within 21 days of the expiry of each quarter, a statement containing particulars of all bill of exchange forms prepaid with cheque duty supplied to its customers or procured on its behalf during that quarter. If cheque duty has not been prepaid, every bill of exchange drawn or made in New Zealand on which duty is payable must be stamped by the drawer or maker of it before it leaves his or her hands.

Cheque duty is set at the rate of 5¢ per bill of exchange or 5¢ per form when the duty is prepaid.

¶30-280 Cheque duty exemptions [SCD ss 79, 80, 85]

No cheque duty is payable on any bills of exchange drawn or made:

- by any person acting on behalf of the Crown other than a person to whom s 80 of the Stamp and Cheque Duties Act 1971 (SCD) applies (see below under "Exemption from cheque duty by agreement")
- under the National Provident Fund Act 1950
- by or on behalf of the trustees of a war fund subject to the War Funds Act 1915
- by or on behalf of CORSO
- by or on behalf of any Provincial Patriotic Council or Welfare Committee under the Patriotic and Canteen Funds Act 1947
- by or on behalf of a friendly society or credit union registered under the Friendly Societies and Credit Unions Act 1982
- by or on behalf of an industrial and provident society registered under the Industrial and Provident Societies Act 1908
- by any electric power board under the Electric Power Boards Act 1925 or by any railway board under the Local Railways Act 1914
- overseas in favour of any person mentioned above if, had the bill been drawn by that person, it would not have incurred cheque duty
- in a set, in accordance with the custom of merchants or bankers, when one of the other bills in the set is duly stamped and the others are not issued or in some manner are negotiated apart from the other one stamped, or
- by a new board of trustees as such boards are deemed by the School Trustees Act 1989 to be agents of the Crown and therefore exempt from cheque duty.

Exemption from cheque duty by agreement

The Commissioner has the power to enter into an agreement with certain persons or corporations for the purpose of exempting them from payment of cheque duty in the normal manner. Cheque duty is still payable but by composition rather than on an individual transaction. Section 80 of the SCD exempts the following bodies:

- Public Trust when acting otherwise than on behalf of the Crown
- the Government Life Insurance Corporation
- the State Insurance General Manager
- Housing New Zealand Corporation, and
- the Accident Compensation Corporation.

Refunds

An application for a refund of cheque duty must be made in writing within eight years of the date of payment of the duty. No refund is made if the duty amounts to less than $1.

¶30-290 Penalties [SCD s 99A; TAA s 144]

A late payment penalty of 5% followed by a monthly incremental 1% charge applies to cheque duties not paid by the due date. The initial 5% late payment penalty is charged in two stages. The first 1% is charged the day immediately following the due date for payment of the duty. The remaining 4% is charged if the duty remains unpaid seven days after the due date. Use of money interest is also charged on late payments and underpayments of duty.

Civil penalties under ss 141A–141E of the Tax Administration Act 1994 (TAA), ranging from 20% for not taking reasonable care to 150% for evasion, can also be imposed by the Commissioner. In the case of evasion, offenders may also be convicted and liable to pay a fine of up to $50,000. If convicted for evasion, the maximum term of imprisonment is five years. See ¶14-260.

Failure to comply with certain technical requirements of the Stamp and Cheque Duties Act 1971 constitutes a criminal offence under s 144 of the TAA. Fines range from $12,000 to $20,000.

APPROVED ISSUER LEVY

¶30-300 Approved issuer levy [IT07 ss GB 26, RF 12(3); SCD ss 86F, 86I, 86J]

Background

Approved issuers are able to pay interest to non-residents without deducting non-resident withholding tax (NRWT). See ¶26-450. Approved issuers are required to pay a levy for the right to issue securities that are subject to the approved issuer regime. The levy is calculated at a rate of 2¢ for every dollar of interest paid on the security. The levy is a charge on the payer and is not deducted from the interest paid to the non-resident lender. If the cost of the levy is to be recovered from the recipient, it must be shown as a fee or charge. A person other than the approved issuer can pay the levy for the approved issuer.

For a zero-rate of NRWT to apply in respect of interest paid by an issuer to an overseas lender:

- the issuer must apply and be approved as an approved issuer (see ¶30-310)
- the security in respect of which the interest is paid must be registered with the Commissioner (see ¶30-320), and
- the approved issuer levy must be paid in respect of every dollar of interest paid (see ¶30-330).