

Theoretical basis

This theoretical basis, which could possibly lead to great hardship when applied in practice, was explained by the Court of Appeal in *North Island Wholesale Groceries Ltd v Hewitt* (1982) 5 NZTC 61,289. It is not difficult to conceive of a case in which a taxpayer may be adversely affected when the Commissioner retrospectively alters a ruling or changes policy. See, for example, *Case S80* (1996) 17 NZTC 7,501 and *Case S79* (1996) 17 NZTC 7,497. In *C of IR v AGH Finance Ltd* (1985) 7 NZTC 5,010, Cooke J stated at 5,012:

If a taxpayer has put a proposal fully and fairly before the Commissioner or a District Commissioner and has received an assurance representing a view which could reasonably be taken as to factual or discretionary questions on a correct understanding of the law, I would be slow to adopt a different view, not because of any estoppel but simply because the considered view of the department at that time would be entitled to weight.

¶1-525 Binding rulings on taxation [IT07 s ZA 4; TAA Pt 5A, ss 3(1), 138E(1)(ea)]

A system of binding rulings, Pt 5A of the Tax Administration Act 1994 (TAA), has been in place since 1 April 1995. It allows the Commissioner to issue rulings on the future application of specific tax legislation.

The types of rulings available are divided into four categories: public, product, private (including advance pricing agreements (APAs)) and status rulings.

Taxpayers are not bound by a ruling. The Commissioner, on the other hand, is bound by the rulings she issues.

Binding rulings are not disputable decisions, and it is not possible to challenge rulings through the disputes resolution process. See s 138E of the TAA. Nor is there any separate right to appeal against a ruling.

See also Inland Revenue (IR) guide to binding rulings (IR 715).

With effect from 7 September 2010, ss 120W and 141B(1D) and a new definition in s 3(1), "Commissioner's official opinion", were added to the TAA to ensure that taxpayers who rely on official IR advice will not be subject to use of money interest or to the unacceptable tax position penalty. See ¶14-115 and ¶14-200.

Public rulings

Public rulings are initiated by the Commissioner and provide the Commissioner's interpretation of particular tax legislation in a given fact situation. Taxpayers who calculate their tax liability in line with the ruling may expect to be assessed in accordance with the Commissioner's stated interpretation of the relevant legislation. Notice of the making of a public ruling is posted in a publication of the Commissioner's choice. Usually the text of the ruling is published in a Tax Information Bulletin. Public rulings apply for the duration of the period or income year specified in the ruling.

The Commissioner can issue public binding rulings that apply for an indefinite period. Whether a public ruling is issued for a finite or an indefinite period is at the Commissioner's discretion. If a ruling issued for an indefinite period is withdrawn, the ruling will continue to apply to an arrangement entered into before it was withdrawn for three years from the date of withdrawal. As with rulings issued for a finite period, a public ruling issued for an indefinite period will cease to apply following a legislative change if the repeal or amendment changes the way the taxation law applies in the ruling. See ss 91D–91DE and 91G of the TAA.

Private rulings

In contrast to public rulings, private rulings are initiated by taxpayers who require confirmation as to how the legislation will apply in relation to a particular transaction. Strict disclosure requirements are imposed on taxpayers seeking such rulings. The private ruling binds the Commissioner only in respect of the particular person and arrangement identified in

the application. Private rulings are charged for by IR on a full cost-recovery basis. From 2 November 2012, the application fee charged is \$280 plus GST (if any), with an hourly rate of \$140 plus GST (if any) thereafter. Private rulings are not published. See the Tax Administration (Binding Rulings) Regulations 1999.

The Commissioner can refuse to issue a ruling if a taxpayer has an outstanding debt relating to an earlier binding ruling application. Also, a binding ruling cannot be made on a question of fact.

In QB 07/05: "Ability to rule where the Commissioner is auditing or investigating — whether the Commissioner has a discretion to rule or is prohibited", published in *Tax Information Bulletin* Vol 19, No 10, November 2007, the Commissioner confirmed that she is prohibited from making a private ruling where a tax audit or investigation is occurring. Note that the Commissioner is allowed to make a private binding ruling if the arrangement is subject to a dispute by way of notice of proposed adjustment (NOPA) but the application for the ruling relates to a different tax type from that in the NOPA. See s 91E(4)(ga) of the TAA.

In May 2008, the Commissioner issued "Questions we've been asked" QB 08/01, which discusses whether the Commissioner can issue a private ruling when a taxpayer has already filed their tax return and therefore made a self-assessment. The Commissioner concludes that s 91E(4)(f) prevents her from issuing a private ruling where a taxpayer has already made a self-assessment by filing their tax return. In such cases the disputes resolution process would be available to the taxpayer (see ¶4-090 and ¶4-135).

In July 2014, the Commissioner issued Questions we've been asked, QB 14/07, "Tax Administration Act 1994 — Proscribed questions", which discusses whether the Commissioner may include a statement relating to a "proscribed question" in a private or product ruling. The Commissioner concludes that including a statement relating to a proscribed question (such as a reference to a person's intention) in the description of the arrangement, or as an assumption or a condition, will not breach the provision that prevents the Commissioner from making a ruling that requires her to determine a proscribed question.

For the purpose of private and product rulings, an "arrangement" includes facts that the Commissioner considers are material or relevant as background or context to the ruling. See s 3(1) of the TAA, definition of "arrangement".

Despite being empowered to make a private ruling on request, the Commissioner may decide not to make a ruling to the extent to which it relates to how the Commissioner may adjust a taxpayer's taxable income under s GA 1 if an arrangement is void under s BG 1. See s 91E(3B) of the TAA.

Application for a private ruling is made by submitting a completed IR 713 to Technical Services, Office of the Chief Tax Counsel. An applicant will need the following:

- the applicant's details and IR number
- an explanation of the issue(s) in question and a full description of the facts
- the taxation laws on which the ruling is sought
- the names of all other parties to the arrangement
- the relevant documents that relate to the question(s) raised, and
- a draft ruling.

Transfer pricing

If the private ruling relates to a transfer pricing arrangement, then the applicant must confirm that they have examined the application and that the information disclosed to the Commissioner is comprehensive by completing an IR 713A declaration, as well as an IR 713.

Advanced pricing agreements (APAs) are a type of private ruling that addresses transfer pricing compliance issues from a co-operative approach. They offer a practical solution to complex transfer pricing cases. The aim is to encourage upfront compliance and to resolve

Extension to time limit

The four-year time bar may be extended:

- for up to 12 months by written agreement in form IR 775 between the Commissioner and the taxpayer (note that the form must be delivered to the Commissioner before the expiry of the four-year period), and
- for a further six months after the end of the 12-month period by written notice given by the taxpayer.

Despite any agreed extension to the time bar, the time bar still applies to an assessment made on a ground that was not identified and not known to the taxpayer and the Commissioner before the time at which the time bar would have applied if the extension had not been agreed to. In other words, the Commissioner is not allowed to raise new issues during the period of the time bar waiver.

In *Tax Information Bulletin* Vol 8, No 3, August 1996 at 34, it is stated that there are two probable situations when a taxpayer might elect to waive the time bar. The first is when the dispute is not resolved and more time would allow completion of the disputes resolution procedures with the mutual agreement of both parties. This would obviate the need for the Commissioner to issue an assessment. The second is when there is another case before the court which is likely to resolve the issue in the current dispute.

See [46]–[52] of the standard practice statement SPS 11/05, “Disputes resolution process commenced by the Commissioner of Inland Revenue”, released in October 2011, for a discussion on the exceptions to the statutory time bar. This SPS applies from 13 October 2011 and replaces SPS 10/04. This SPS is published in *Tax Information Bulletin* Vol 23, No 9, November 2011 at 16.

GST returns

Except in cases in which a taxpayer has knowingly or fraudulently failed to make full and true disclosure of all material facts necessary to determine the taxpayer’s GST liability, there is also a four-year time bar for GST returns filed. Generally the time allowed for making or amending assessments is limited to four years from the end of the GST return period in which the GST return was provided. See s 108A of the TAA.

The extension of the four-year time bar also applies to GST returns.

Change in accounting practice

Certain amounts must be included in income and certain amounts are allowed as a deduction when a taxpayer changes from a cash accounting method to an accrual accounting method, or vice versa: see s EG 2 of the Income Tax Act 2007. The Commissioner’s power to reassess a taxpayer’s tax liability in this situation continues to be governed by s 108 of the TAA. For further discussion on s EG 2, see ¶5-097.

¶4-115 No time limit for amending assessments or determinations

Several provisions of the Income Tax Act 2007 and the Tax Administration Act 1994 (TAA) provide that the Commissioner may issue an amended assessment regardless of the four-year time limit imposed under s 108 of the TAA and, therefore, irrespective of whether there has been any element of tax evasion. Some of those provisions are as follows:

- s EZ 42(5) for a post facto adjustment made to a financial arrangement under the old financial arrangements rules
- ss EH 27 and EH 57 concerning assessment of income equalisation refund upon retirement or death
- s LA 6(3) in relation to the use of remaining refundable credits
- s 39(4) of the TAA for assessments required in consequence of a change of balance date

¶4-115

- s 44B of the TAA for an adjustment made to a financial arrangement under s EW 53
- s 113B of the TAA concerning dividends recovered or repaid
- s 113C of the TAA concerning attributed repatriation dividends
- s 135(3) of the TAA concerning determinations or assessments made by the Taxation Review Authority or the Commissioner in conforming to a determination of the Authority, and
- s 136(19) of the TAA concerning determinations or assessments made by the High Court or the Commissioner in conforming to the Court’s determination.

¶4-118 Reaching agreement after an Inland Revenue audit

Inland Revenue (IR) has long had a practice of resolving tax disputes that arise after a tax investigation by reaching agreement with the taxpayer concerned. Such agreements, once finalised and signed by both parties, are binding (subject to certain exceptions outlined below). This procedure for making agreements is outside the formal disputes process outlined at ¶4-120, and only applies if no assessment has been issued. IR’s practice guidelines for settling disputes once an assessment has been issued and challenge proceedings commenced are outlined at ¶4-252.

IR originally released a draft standard practice statement (ED0008) in October 1999 that set out the principles and parameters IR proposed to follow when finalising agreements after a tax investigation. However, ED0008 was never finalised and in July 2014 IR released a further draft standard practice statement ED0151. This draft sets out how taxpayers and IR staff should seek to resolve matters that are in doubt or in dispute when an investigation is being finalised. Once the draft is finalised and becomes operative, it will replace standard practice statement INV-350, “Finalising agreements in tax investigations” (August 1998), which is currently listed as under review. The draft states that it is essential for IR and taxpayers that a code of good practice as to how issues are resolved and agreements finalised be defined. The draft is intended to ensure taxpayers will be treated consistently when entering discussions and negotiations, and will be treated impartially and in accordance with the law by IR.

The draft states that IR will not negotiate a final agreement if:

- an amount is clearly assessable or a deduction, rebate or credit is clearly not allowable
- IR’s view of the law on a particular issue is firm and this view is supported by the evidence
- the only consideration is the taxpayer’s ability to pay
- an adjustment can be made only on an “all or nothing basis”, ie either an adjustment would be made for the total amount in question or no adjustment made at all, or
- there is a penalty and/or prosecution action.

The circumstances in which IR may enter into negotiations are:

- the quantum of a disputed amount depends on the facts
- an adjustment may rely on a question of valuation for which there are competing bases
- an item may not be subject to precise computation — for example, the estimation of living expenses in an asset accretion assessment, or
- an issue of quantum or valuation has been resolved for one period and is likely to apply to prior periods.

Penalties, if applicable, should be discussed and can be included in the final agreement. This includes shortfall penalties and late payment penalties. Failure to agree on penalties will not preclude an agreement on the substantive issues, as the penalties issue can be continued under the disputes resolution process.

¶4-118

No guidance is given for facilitating a determination that the excepted financial arrangement ceases to be used for a private or domestic purpose. This would be a question of fact in any one case.

Example 1:

Mr KP is a motor vehicle dealer who raises a USD loan to purchase a Humvee vehicle and uses it for private motoring. Six months later, Mr KP decides to sell the vehicle through his business. The USD loan becomes a financial arrangement probably at the point at which Mr KP starts to display the vehicle for sale.

► **Note:** The second category is provided for in s EW 8. That section was amended in 2013, with effect from 27 September 2012, to apply only to a person carrying on a business of acquiring short-term agreements for sale and purchase for the purpose of collecting amounts owing at the time of acquisition. The person could then choose to treat all such acquired agreements as financial arrangements. However, the amendment was later repealed in 2014 and the original provision was restored. An additional amendment added the requirement for the expenditure to satisfy the general permission and not be denied a deduction by a general limitation, with effect from 17 July 2013. A savings provision preserves an election made under s EW 8 as amended in 2013, provided a tax position was taken in a return received by the Commissioner, or a determination or binding ruling made by the Commissioner, before 14 April 2014 and the person chose to continue to take that tax position after that date.

Note, however, that at the time s EW 8 was amended in 2013, an additional amendment inserted s ED 4 and that section remains. That section provides that when a taxpayer has one of the five excepted financial arrangements listed above that is denominated in a foreign currency, they may choose to value any debts outstanding under the excepted financial arrangement at the same spot exchange rate they use in preparing financial statements. This rule is optional, but once a taxpayer elects into the rule for an excepted financial arrangement, they must continue to apply the rule to all of their excepted financial arrangements that are of the same type. A taxpayer's decision to elect into the rule will be reflected in the tax position they take in their return of income for the year. No prior notice of election is required.

An election under s EW 8 is made by preparing the tax return for the year of election on the basis that the excepted financial arrangements are financial arrangements. That would involve the application of a spreading method to the financial arrangements. A category-by-category approach may be adopted or a class approach for short-term agreements. The election does not need to be made for all categories or classes that are potentially subject to an election.

An election may be revoked. The revocation is achieved by giving the Commissioner notice of the revocation within the time allowed for the filing of the tax return for the year in which the notice of revocation is given. The revocation applies prospectively, extending to excepted financial arrangements entered into after the year of election. Financial arrangement treatment would continue to apply to those financial arrangements held at the end of the year of revocation, until such time as they are sold or they mature.

Consideration

The definition of a financial arrangement refers to a receipt of money "in consideration for" money to be provided in the future. The notion of consideration is not defined. Some reference can be made to the general principles on the meaning of the concept.

Consideration is a feature of every contract. To be a contract, the agreement in question must be supported by consideration. Under the law of contract, consideration, as traditionally conceived, involves either some detriment to the promisee or some benefit to the promisor. An alternative definition adopted by the House of Lords is that consideration is the price for which the promise of the other is bought. See *Dunlop v Selfridge* [1915] AC 847.

These propositions were outlined by the High Court in *Cooper v C of IR* (1995) 17 NZTC 12,216. This case concerned the construction of a loan agreement that provided that the borrowers would be discharged from all liabilities under the loan, if the lender became

insolvent. In due course, the lender became insolvent and was wound up. The Court held that the borrowers had been discharged from making all remaining loan payments without consideration. The Court made no reference to the alternative possibility that consideration had been provided when the loan was entered into. At that time, the lender agreed to discharge the borrowers upon the lender's insolvency, and it was not explained why it was necessary that the borrowers should give additional consideration to obtain the discharge when insolvency eventuated.

There is an element of reciprocity in the concept of consideration. No such element was found to be present for GST purposes where a corporate body for a time share resort merely collected contributions from its members and passed them on. See *Taupo Ika Nui Body Corporate v C of IR* (1997) 18 NZTC 13,147.

It is not every benefit or advantage which accompanies or follows a disposition that can be regarded as consideration. There must be an element of bargain that ties the benefit to the disposition. The benefit must be given in return for the disposition and be enforceable by the donor. See the gift duty case of *Baigent v C of IR* (1979) 4 NZTC 61,628 (CA).

The concept of consideration for stamp duty purposes in one case was held to be what the vendor of an asset receives in order to move the transfer of the asset to the purchaser. This was in the context of a case that concerned the dutiable value of an agreement for the sale and purchase of shares, the agreement also providing that the target company would pay a pre-settlement dividend to its shareholder as vendor. A majority of the High Court of Australia held that the amount of the dividend should be taken into account in computing the consideration. Receipt of the dividend was part of the payments which induced the vendor to transfer the shares it held in the target company. The minority of the Court thought that the consideration for the dividend was provided upon the original subscription for share capital in the target company. When the shares were subscribed for, the subscription was in consideration of the company's promise to apply its assets in various ways, such as by paying dividends. See *Chief Commr of State Revenue (NSW) v Dick Smith Electronics Holdings Pty Ltd* 2005 ATC 4052.

The Commissioner discussed the concept of consideration in the course of addressing the question of whether school fees and activity fees paid to a state school attract GST. See *Tax Information Bulletin* Vol 15, No 7, July 2003 at 10.

What is not a financial arrangement

Under s EW 4, some transactions are not a financial arrangement.

An absolute assignment of some or all of a person's rights under a financial arrangement is not a financial arrangement. This is provided that there is no deferral of payment of any of the consideration for the assignment.

A legal defeasance that releases a person from some or all obligations under a financial arrangement or an excepted financial arrangement is not a financial arrangement. This is provided that there is no deferral of payment of any of the consideration for the defeasance. The notion of a legal defeasance encompasses the release from the primary obligation owed under a financial arrangement, which is formally acknowledged or established by legal judgment.

These exclusions may be regarded as confirmatory in nature, because the absence of deferral indicates that the assignment or defeasance would not have been within the scope of the definition of a financial arrangement.

The contractor also incurs the expenditure of the retention money payment to the sub-contractor in the income year in which all repairs are completed and omissions rectified, because that is when the contractor becomes definitively committed to make the payment. It is this that determines when the expense is incurred and not the due date for the payment. If the repairs and rectifications must be certified by a third party, for example, by an engineer, the contractor incurs the expenditure when that certificate is given as that is when the contractor becomes definitively committed to make the payment.

RELATED TOPICS

¶7-400 Trustee distribution [IT07 ss FC 1-FC 5]

A distribution by a trustee to a beneficiary of land that is subject to the land disposal provisions is treated as a disposal of the land at its then market value. This may require the trustee to recognise income upon the distribution.

The beneficiary is treated as having a cost of acquisition that is the same as the trustee's disposal value. That would provide a cost base for the beneficiary, in the event that the beneficiary holds the land on revenue account.

The same rules apply upon a resettlement of land that is subject to the land disposal provisions on another trust. Effectively, there is a disposal and acquisition of the land at its then market value.

¶7-405 Death of a person [IT07 ss FC 1-FC 5]

The death of a person who owned land at the time of death that is subject to the land disposal provisions will give rise to two disposals. These are:

- the vesting of the land in the administrator or executor of the deceased's estate (s FC 1(1)(a)), and
- a distribution by the administrator or executor to a beneficiary of the estate, whether under the will or upon an intestacy (s FC 1(1)(b)).

Provision is made for roll-over relief to be applied to the disposal, which means that the land will pass to the recipient and the disposal will be treated, in certain circumstances, in the same manner as a relationship property transfer taking place at tax book value (see ¶7-400). That treatment applies to the following two categories of disposal:

- the vesting of the land in the executor and its later distribution to an estate beneficiary where:
 - the land is to pass to the surviving spouse, civil union or de facto partner, and
 - estate beneficiaries who are close relatives are to receive all estate assets comprising tax-base property which is defined as revenue account property, foreign investment fund interests, financial arrangements not accounted for on a cash basis and depreciable property. A close relative in this context is defined as a surviving spouse, civil union or de facto partner, and a person who is within the second degree of relationship to the deceased (eg grandparents, grandchildren, brothers or sisters)
- distribution of the land by the executor to a beneficiary who is a close relative or a charity, either of whom is to receive all estate assets comprising tax-base property as above and where all of the following apply:
 - the estate creates no life interest over the property
 - no trust is created for the estate, apart from during the period of its administration, and
 - during administration, the estate's net income is distributed to the maximum extent possible.

The Commissioner has indicated that this second category can continue to apply if the will provides for legacies of assets that are not within the tax base. Possibly, the Commissioner had in mind legacies, such as jewellery and motor vehicles. Less certain is the position in relation to a cash legacy granted to a friend of the deceased. The focus of the second category is on the beneficiaries who are to receive the deceased's revenue account assets. Since a cash legacy does not deal with taxable assets, it may be that such a provision does not prevent application of the second category. See *Tax Information Bulletin* Vol 17, No 7, September 2005 at 43.

If the book value approach is not available, a market value treatment applies. The treatment becomes as follows:

- the executor is treated as having acquired land, subject to the land disposal provisions immediately before the death of the deceased at its then market value
- a beneficiary of the estate to whom the land is distributed is treated as acquiring the land at the same market value.

10-year rules

The effect of a person's death on the 10-year rules incorporated in the land disposal provisions is addressed in s FC 5. The first topic dealt with is the categories of land disposal income relating to the disposal within 10 years of a dealer's other land (¶7-065), a developer's other land (¶7-085) and a builder's other land (¶7-095). If an interest in land potentially subject to those provisions is to vest in a beneficiary who is a close relative of the deceased, they do not operate to create income upon:

- vesting of the land in the executor, and
- distribution to the beneficiary.

A similar approach is provided for in relation to land affected by zoning change and disposed of within 10 years of acquisition (¶7-135). That category of land disposal income does not operate to create income upon the land vesting in the executor, or when the executor distributes the land to an estate beneficiary. This is provided that a beneficiary who is a close relative receives an interest in the land.

"Close relative" is defined in s FC 1(2) to mean a surviving spouse, civil union partner, or de facto partner of the deceased person. It also includes any person who is within the second degree of relationship to the deceased person.

In the event that any of the 10-year provisions are not prevented from having application, there is an attribution of costs. The executor or beneficiary is imputed with the cost of purchase by the deceased and any further costs incurred by the deceased that have not already been allowed as a deduction. The executor or beneficiary may take those costs into account in determining the income arising under the land disposal provisions relating to other land and rezoning gains. Note that the concessions do not apply to land of the deceased that is subject to the rule for developments or divisions begun within 10 years.

► **Note:** The Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014, enacted 30 June 2014, has clarified that expenditure incurred by the executor or administrator on land can also be included as part of the cost of the land when calculating profits on disposal. This change comes into force on 1 April 2008 and applies from the 2008/09 income year.

¶7-410 In specie distribution [IT07 ss FC 1(1)(d), FC 2(1)]

Land subject to the land disposal provisions that is distributed by a company to a shareholder may result in dividends (¶16-550). In that event, the land is treated as having been disposed of by the company for its market value and acquired by the recipient for market value on the date of the distribution.

Taxpayers can choose how much of a qualifying deduction will be allocated to a future income year. The unallocated amount can be claimed as a deduction in the year the expenditure was incurred. Taxpayers can choose not to allocate any of their expenditure to future income years but instead apply the ordinary rules.

Allocation of deductions

Deductions that qualify must be allocated to an income year in which assessable income is derived that would not have been derived but for the research and development expenditure or the use of or disposal of property used in carrying out research and development.

The amount of qualifying deductions allocated to a particular income year is the lesser of:

- the amount of assessable income derived that would not have been derived but for the research and development expenditure (or depreciation), and
- the amount of qualifying deductions that has not already been allocated to an income year.

This means that taxpayers who choose to allocate deductions to future income years can only allocate the qualifying deductions to the extent of any research and development income derived in that year. Under s EJ 23, the deductions cannot be allocated against non-research and development income. However, this does not prevent the taxpayer being able to claim qualifying deductions in the current year if the loss-carry forward rules in Pt I are satisfied. See ¶1-320 and ¶1-330.

A taxpayer's decision as to the allocation of deductions under the rule is reflected in the tax position taken in the annual tax return. A position taken in a tax return is binding on a taxpayer.

Recent proposals

In July 2013 Inland Revenue released a tax policy paper, "R&D tax losses", with proposals to improve cash flow and remove tax distortions on research and development costs for start-up New Zealand businesses. The paper recognised that, under current rules, tax losses must be carried forward and deducted against future taxable income. Early-stage businesses often endure particularly long periods of tax loss, meaning they cannot access the benefit of loss deductions when they need it most. The paper contained suggested changes targeted at R&D intensive start-up companies.

Budget 2014 followed up the suggested changes in the issues paper with details of legislation to be included in the next omnibus taxation bill. The main points are as follows:

- Innovative start-ups will be able to "cash-out" an amount of their tax losses arising from qualifying R&D expenditure. This means that instead of carrying the tax loss forward to apply against future assessable income, the company will receive a cash payment.
- Innovative start-ups will be able to cash-out up to \$500,000 of eligible tax losses in the first year of the initiative (under a company tax rate of 28% this is equivalent to a cash-out of \$140,000). This cap will rise by \$300,000 each year up to an eventual maximum of \$2m (a cash-out of \$560,000 per year).
- Companies that eventually earn assessable income will return the value of the cashed-out loss through taxes paid on that income.
- Companies that make a successful return on their investment through a non-taxable capital gain will have their cashed-out losses reinstated as losses to carry forward by repaying the value of the cashed-out loss out of the gain made.

The cashed-out loss will provide a timing benefit for these companies on their tax losses arising from R&D expenditure, reducing the bias against R&D investment arising from current tax settings and their cash-flow constraint. As the intention is to provide a timing benefit only and not a grant, companies are obliged to eventually return the value of any cashed-out loss taken by either taxes paid or from any gain on sale.

The policy is targeted at innovative New Zealand start-up companies in a tax loss position. The two main eligibility criteria are:

- 20% of a company's expenditure on wages and salaries must be on R&D. This includes expenditure on shareholder salaries, contracted labour and 66% of contracted R&D, but does not include sweat equity.
- A company must be carrying out eligible R&D, the definition for which will be consistent with that used by the relevant accounting standard (NZIAS 38 Intangible Assets).

If the company is part of a group, the group must also meet the tax loss requirement and wage intensity threshold.

The applicant must be a company resident in New Zealand (and not treated as non-resident under a double tax agreement). The company also cannot be a look-through company, listed company, qualifying company or special corporate entity.

Loss recovery rules would be included to protect the neutrality and integrity of the suggested policy, while also minimising its fiscal risk. These rules would recover the value of the cashed-out loss when:

- the company sells intellectual property
- 90% of the company's shares are sold
- the company becomes non-resident (for tax purposes), or
- the company is liquidated.

The value of the cashed out loss would be reinstated as R&D expenditure to be allocated to subsequent years to align with the setting that allows R&D losses to survive a continuity test.

The new policy is intended to apply from income years beginning on or after 1 April 2015.

► **Note:** A further government consultation document, "Black hole R&D expenditure", was released in November 2013. This sought feedback on proposals to settle problems around the tax deductibility of various types of business-related research and development expenditure. While the Government announced a set of black hole expenditure proposals as part of Budget 2013, the proposals in the document went beyond those initial proposals.

Feedback was sought on the following:

- ensuring that capitalised development expenditure that relates to certain depreciable assets is able to be depreciated over the legal life of the asset to which it relates
- clarifying that capitalised expenditure incurred by a taxpayer in the successful development of software for use in their own business is depreciable, and
- allowing an immediate tax deduction for capitalised development expenditure that gives rise to an unsuccessful asset — providing certain criteria are met.

Following feedback on those proposals, the government announced proposed legislative changes as part of Budget 2014. The main proposed changes are:

- *R&D that results in a depreciable intangible asset* — Capitalised development expenditure (incurred on or after 7 November 2013) that relates to a patent, patent application or plant variety rights will be allowed to be included as part of the depreciable costs of the relevant depreciable intangible asset, for taxpayers that have carried out research and development (R&D) that has led to them acquiring one of these depreciable intangible assets.
- *R&D that does not result in a depreciable intangible asset* — A one-off tax deduction will be allowed for capitalised development expenditure (incurred on or after 7 November 2013) upon the intangible asset to which it relates being written off for accounting purposes, for taxpayers that have developed intangible assets that are not depreciable for tax purposes. This will apply irrespective of whether the asset was useful for a period or the R&D was unsuccessful.

The penalty does not apply where the taxpayer is negotiating an instalment agreement to pay the unpaid amount. It applies where the taxpayer agrees, before the penalty date, to an instalment arrangement of the same type as provided for in s 177B, and pays the unpaid amount under that instalment arrangement. There is also a limited exception from the shortfall penalty for receivers or liquidators who have insufficient funds to pay the schedule amount. See s 141ED(3).

Under s 183F(1)(c) a taxpayer will not be liable to pay a penalty for not paying an EMS amount if the unpaid amount on the day before the date of the Commissioner's notice under s 141ED(1)(b) is \$100 or less.

¶14-125 Reduction of penalties for previous behaviour [TAA s 141FB]

Shortfall penalties may be reduced by 50% if a taxpayer has a past record of "good behaviour" or good compliance.

The shortfall penalties imposed under ss 141A–141E will be reduced to 50% if the taxpayer is not:

- convicted of a disqualifying offence, or
- liable for a disqualifying penalty.

A "disqualifying offence" means:

- an offence under s 143A, 143B, 143F, 143G, 143H or 145 for which a conviction is entered on or after 26 March 2003 and before the taxpayer takes the tax position to which the current penalty relates
- an offence under s 143 or 144 that relates to the same tax type as the current penalty and for which a conviction is entered on or after 26 March 2003, within the specified time period and before the taxpayer takes the tax position to which the current penalty relates.

The specified time periods are:

Tax type	Time period
Income tax and other tax types	four years before the tax position was taken to which the current penalty relates
PAYE, GST, FBT, RWT	two years before the tax position was taken to which the current penalty relates

The definition of a "disqualifying penalty" in s 141FB depends on which shortfall penalty is being considered. For the reduction of a shortfall penalty imposed under any of ss 141A–141D, a "disqualifying penalty" is defined as a shortfall penalty that:

- relates to the same tax type as the current penalty
- if the current penalty is for gross carelessness or taking an abusive tax position, is a shortfall penalty for evasion or a similar act or for gross carelessness or taking an abusive tax position
- if the current penalty is for not taking reasonable care or taking an unacceptable tax position, is a shortfall penalty of any sort
- is not reduced for voluntary disclosure by taxpayer, and
- relates to a tax position that is taken on or after 26 March 2003, within the specified time period, and before the date on which the taxpayer takes the tax position to which the current penalty relates.

The shortfall penalties for not taking reasonable care, for taking an unacceptable tax position, for gross carelessness and for taking an abusive tax position are reduced by 50% if the taxpayer has not been liable to pay a shortfall penalty within the previous four years. The four-year period is reduced to two years in the case of shortfall penalties imposed in respect of PAYE, fringe benefit tax, goods and services tax and resident withholding tax.

¶14-125

Only shortfall penalties imposed in respect of the same tax type are taken into account so that, for example, a shortfall penalty imposed within the two-year period that applies in respect of PAYE will not prevent a shortfall penalty relating to fringe benefit tax being reduced for "good behaviour". Furthermore:

- penalties reduced as a result of voluntary disclosure are not taken into account, and
- shortfall penalties for not taking reasonable care and for taking an unacceptable tax position are not counted in determining whether a shortfall penalty for gross carelessness or taking an abusive tax position should be reduced for "good behaviour".

For the reduction of a shortfall penalty imposed under s 141E, "disqualifying penalty" is defined as a shortfall penalty that:

- relates to the same tax type as the current penalty
- is for evasion or a similar act
- is not reduced for voluntary disclosure by taxpayer, and
- relates to a tax position taken on or after 26 March 2003 and before the date on which the taxpayer takes the tax position to which the current penalty relates.

The "good behaviour" period is not limited to four years in the case of the shortfall penalty for evasion or a similar act. This shortfall penalty is reduced by 50% only if the taxpayer has not previously been liable for a shortfall penalty for evasion or a similar act. In determining "good behaviour", only shortfall penalties imposed for evasion or a similar act for the same tax type are taken into account and penalties reduced as a result of voluntary disclosure are not counted.

For shortfall penalties imposed under any of ss 141A–141E, a taxpayer will be treated as not liable for a shortfall penalty that relates to a tax shortfall arising from another tax position taken by the taxpayer, if:

- the Commissioner identified both tax shortfalls in the same investigation or voluntary disclosure, and
- the taxpayer:
 - takes both tax positions on the same date
 - is not liable for a shortfall penalty within the specified time period prior to taking the tax position.

Standard practice statement

Standard practice statement SPS 06/03, "Reduction of shortfall penalties for previous behaviour", sets out the Commissioner's policy regarding the practice of reducing shortfall penalties imposed under ss 141A–141E for previous behaviour in accordance with s 141FB. The statement replaces standard practice statement INV-295 and applies to shortfall penalties imposed on or after 21 December 2004. Key comments in the statement include:

- Generally, a taxpayer will be convicted of a disqualifying offence when the taxpayer is sentenced. A guilty plea is not a conviction.
- If a taxpayer is convicted of but discharged from a disqualifying offence, the taxpayer will be treated as if the taxpayer has been convicted.
- If a taxpayer is discharged from a disqualifying offence without conviction, the taxpayer has not been convicted of a disqualifying offence for the purposes of s 141FB.
- A reduction in a shortfall penalty for previous behaviour applies separately to each tax type, ie a penalty imposed in relation to PAYE does not preclude a previous behaviour reduction for a later shortfall penalty relating to GST.
- The start date of the probation period is determined by counting back from the date the taxpayer takes the tax position giving rise to the current penalty.

¶14-125

¶15-115 Payment to RWT exemption certificate holder [IT07 ss RE 5, RE 29]

A payment does not constitute resident passive income subject to withholding tax when the recipient holds an RWT exemption certificate. An exemption from the obligation to make a deduction exists when a person (the payer) makes a payment to another person (the recipient) or receives the payment as agent or bare trustee for the recipient and all of the following conditions are satisfied:

- the payer has taken reasonable steps to confirm that the recipient is a bank, or the payer has been advised by the recipient of the recipient's Inland Revenue (IR) number and the fact that the recipient holds an RWT exemption certificate, or the payer has sighted an exemption certificate issued to the recipient and has taken steps to confirm that the recipient is the person named in the certificate
- no notice of cancellation has been gazetted more than five working days before the money was lent (in the case of interest) or the payment made (in the case of dividends or a taxable Maori authority distribution), or, if cancellation has been published, the payer has sighted a certificate subsequently issued to the recipient
- where the payment is one of interest, no notice of cancellation has been gazetted more than five working days before the date of payment, or, if such a notice has been gazetted, there has been notice of the issue of a further certificate more than five working days before the payment, or the payer has sighted a reissued certificate
- the payer has not been advised by the Commissioner of cancellation of the recipient's RWT exemption certificate more than five working days before the payment or, if so advised, notice of a further certificate has been gazetted more than five working days before the payment or the payer has sighted such a further certificate
- the payer does not have any other grounds for believing that the recipient is not eligible to be issued with an exemption certificate, and
- when the recipient is a registered bank, a building society or a trustee bank, and the resident passive income is not being derived by the bank or society acting as a trustee holding an asset on behalf of a third party, the payer does not have any grounds for believing that the income is being derived by someone other than the recipient.

Compliance issues for payers

Any person paying resident passive income to the holder of an RWT exemption certificate must check that the certificate has not expired. IR considers that all payers should ensure that their systems and procedures properly record the expiry dates and/or cancellation of certificates against the accounts they pay interest to. For example, payers should update their databases with each issue of the *Gazette*. Failure to do so may result in a failure to deduct the correct resident withholding tax (RWT), exposing the payer to a requirement to make up the RWT shortfall and pay any late payment penalties and possible shortfall penalties for lack of reasonable care. See *Tax Information Bulletin* Vol 11, No 2, February 1999 at 13.

Joint accounts

In cases where a person holding a valid exemption certificate has a joint account with another person who does not hold an exemption certificate, IR considers that the payer must deduct RWT from all the interest paid. The certificate holder can, however, claim a tax refund when filing an annual return. See *Tax Information Bulletin* Vol 11, No 2, February 1999 at 12.

¶15-130 Income exceeding \$2 million [TAA ss 32F, 32G]

A person issued with an RWT exemption certificate on the basis that his or her annual gross income for the next accounting year is estimated to exceed \$2m must provide the Commissioner with evidence of his or her gross income within three months of the end of the relevant accounting year. In the case of a company which is a member of a group of companies, the \$2m threshold is satisfied if group income exceeds \$2m. This would enable each group member to obtain an exemption certificate (even though the income of that member will not reach the threshold).

¶15-115**¶15-140 Surrender or cancellation of certificate of exemption** [IT07 s RE 27(2), (3); TAA ss 32K, 32L]**Surrender**

A person who becomes aware that the basis of the exemption as set out in the RWT exemption certificate is no longer satisfied must advise the Commissioner, in writing, within five working days of realising that fact. The certificate must be surrendered to the Commissioner and within five working days, if requested to do so, the person must provide the Commissioner with a list of any persons to whom the certificate has been shown for the purpose of obtaining an exemption from deduction of resident withholding tax.

Cancellation of certificate

An RWT exemption certificate may be cancelled by the Commissioner if:

- the person no longer satisfies the basis upon which the certificate was issued
- the person obtained the certificate on the basis of misleading information
- contrary to the person's estimate, evidence shows that the person did not derive annual gross income of more than \$2 million or satisfactory evidence was not provided of annual gross income of more than \$2m (or such evidence was materially incorrect or misleading) if this was the basis of the exemption (see ¶15-130), or
- the person has not paid any income tax by the due date.

If the person qualifies for another category of exemption, the Commissioner must issue a new certificate in substitution for the cancelled certificate.

Notification by Commissioner

The Commissioner must publish on or before 30 June in every year a list of all certificates cancelled in the past year and a list of certificates issued in the past year to persons who had previously held a certificate, although not in the same year. The Commissioner is also obliged to publish the details on a quarterly basis in relation to the three-month period which terminated at the end of the month preceding the month of gazetting. Certificates of exemption cease to be valid on the fifth working day after they are gazetted as being cancelled. For persons notified of the cancellation, the certificate ceases to be valid as from five working days after the day of that notification.

The Commissioner may also publish by electronic means lists of certificates that have been gazetted.

¶15-160 Unincorporated body [IT07 s RE 30; TAA s 32J]

An "unincorporated body" (eg a partnership, a joint venture, or trustees of a trust) is subject to special rules for the purposes of resident withholding tax (RWT).

When such a body is issued with an RWT exemption certificate in relation to the carrying on of a taxable activity, the following rules apply:

- the members cannot themselves be issued with a certificate in relation to that taxable activity
- payments made in the course of that activity are deemed to be made by the body and not by any member
- payments made to any member acting as a member of that body are deemed to have been made to the body and not to the member
- the certificate is in the name of the body (or trust where the body is the trustee of a trust)
- changes in membership have no effect so far as RWT is concerned except that (1) members are jointly and severally liable while they are members, and their estates are severally liable upon their deaths (where the member(s) are individuals), and (2) membership does not cease until a change of membership is notified in writing to the Commissioner.

¶15-160

¶19-200 LTC: Allocation of income and deductions

[IT07 ss CB 32B, DV 22, HB 1(5), HB 2]

The income, expenses, tax credits, gains and losses of an LTC are allocated to owners in accordance with the owner's effective look-through interest in the company.

The income and deductions available from the LTC may be allocated to the owner of an effective look-through interest even though the owner did not hold the interest at a particular time, such as before the company assumed LTC status.

If the owner's voting interest or market interest varies during the income year the owner may use the weighted average interest to determine their look-through interest.

If the LTC has a market value circumstance in the year, the owner's effective look-through interest is calculated as the average of the owner's voting interest and market value interest in the LTC for the income year.

Alternatively, owners can prepare part-year accounts and allocate income and deductions in accordance with their actual interests held.

Owners may choose which of the above two methods they use to allocate income and deductions, unless the Commissioner requires the LTC to allocate assessable income in accordance with actual interests held by the owners where the income is \$3m or more. See s HB 1(5)(b)(i).

Because an LTC is transparent for income tax purposes, allowable deductions can be claimed by the owners of the LTC, rather than claimed by the company.

¶19-203 LTCs and interest deductibility

[IT07 ss DB 6, HB 1]

Interest may be deductible under s DB 6 provided that the deduction for interest is incurred by the LTC in deriving its assessable income or incurred in the course of carrying on a business for the purpose of deriving its assessable income. See ¶10-021 for the commentary on the general permission relating to deductibility.

Deductibility is subject to the loss limitation rule (see ¶19-215). This ensures that owners can only offset losses to the extent that the losses reflect the owner's economic loss.

Section HB 1(4) attributes the action of the LTC to its owners. Owners are treated as carrying on the activities of the LTC, having the same status, intention and purpose as the company. Owners are also treated as holding property that the LTC holds, being party to any transaction entered into by the LTC and doing a thing that the LTC does. The Commissioner's view is that to borrow funds to purchase a "something" that will derive assessable income for the LTC is included in this definition of "a thing". The effect is that this provision treats the LTC's action as being those of the owner for income tax purposes. The provision does not work in reverse. The underlying principle that supports the deductibility of interest is the use of the borrowed funds by the LTC, not the use of the funds by the person in their personal capacity.

Where a person sells their private home at its fair market value to an LTC as a rental asset to be rented to a third party on an arm's length basis and the LTC borrows money to fund the purchase, an interest deduction will be allowed. Inland Revenue issued "Questions we've been asked" QB 11/03, "Income tax — look-through companies and interest deductibility" (see *Tax Information Bulletin*, Vol 23, No 10, December 2011 at 16), and also that the tax avoidance provision, s BG 1, will not apply, in "Questions we've been asked" QB 12/11, "Income tax — look-through companies, rental properties and avoidance", (see *Tax Information Bulletin*, Vol 24, No 7, August 2012, p 110).

¶19-200

The Commissioner has also released "Questions we've been asked", QB 12/08: "Income tax — look-through companies: interest deductibility on funds borrowed to repay shareholder current accounts" and QB 12/09: "Income tax — look-through companies: interest deductibility where funds are borrowed to pay a payment to shareholders to reflect an asset revaluation". QB 12/08 considers whether interest is deductible where an LTC borrows money on arm's length terms to repay current account loans from its shareholders. It concludes that interest will be deductible to the extent the borrowing replaces current account loans from shareholders that were used directly in the LTC's assessable or excluded income-earning activity or business. The LTC must be carrying on an income-earning activity or business for the purpose of deriving assessable or excluded income both at the time the funds are borrowed and at the time interest on those funds is payable. Interest will not be deductible to the extent the borrowed funds are used to replace current year income. See *Tax Information Bulletin*, Vol 24, No 6, July 2012, p 70.

QB 12/09 considers whether interest is deductible where an LTC borrows money in the following circumstances:

- the LTC purchases an asset from which it derives income
- the asset is subsequently re-valued above its purchase price, and
- the LTC uses the borrowed money to make payments to its shareholders reflecting the increase in the asset's value.

QB 12/09 concludes that the interest will not be deductible under the principle from *Roberts and Smith* (see ¶10-650). A deduction may be available under general interest deductibility principles where the relevant nexus is met (for example, if the funds were advanced to shareholders at a market rate of interest). See *Tax Information Bulletin*, Vol 24, No 6, July 2012, p 72.

¶19-205 Taxation of working owners of an LTC

[IT07 ss DC 3B, RD 5(3B), YA 1]

The owners of an LTC are allowed a deduction for payments made to a working owner. The usual PAYE rules apply to the payments made to the working owner. For an owner to be considered a "working owner" that person must meet the definition set out in s YA 1, which requires that his or her share of salary be paid under a written employment contract and that they personally and actively perform their duties under that contract.

This rule applies as long as the company is not wholly or mainly engaged in the business of investing money or in holding or dealing in shares, securities, investments or land.

From 2 November 2012, for FBT purposes, a working owner is not an employee. Instead, the benefit provided by the LTC to the shareholder is considered as a distribution of profits to that shareholder.

¶19-210 Anti-avoidance rules relating to LTCs

[IT07 ss GB 23, GB 24, GB 25B, GB 29(2)(c)]

The first anti-avoidance measure relating to LTCs applies when two or more owners are relatives and one of those relatives is less than 20 years old. In that case, the effective look-through interests, and consequently the income and deductions, allocated to an owner may be adjusted by the Commissioner, having regard to the services rendered and value of contributions made by the various owners to the company. See s GB 25B.

¶19-210

Additionally, the Commissioner may also determine the amount of provisional tax that a taxpayer should pay under the circumstances set out in accordance with a determination issued by the Commissioner under s 119 of the Tax Administration Act 1994 (where the taxpayer has failed to furnish income tax returns or where the Commissioner considers the taxpayer is required to estimate and has either failed to furnish an estimate or the estimate is considered not fair and reasonable): see s RC 5(7) and ¶22-110.

¶22-075 Standard (uplift) method [IT07 ss RC 5(2)-(4), RC 6, RC 10, RZ 3, RZ 5, YA 1]

The standard calculation method is the default calculation method but it cannot be used if another method is adopted. It applies if other prescribed methods do not, although it is overridden if another method is selected.

Under the standard method, the amount of provisional tax payable for a tax year is:

- 105% of the previous tax year's residual income tax (RIT), or
- for taxpayers who have not yet furnished their preceding tax year's tax return due to an extension of time arrangement, 110% of the RIT of the tax year before the preceding tax year.

Note that the Budget 2010 reduced the basic tax rate for companies and certain widely-held entities such as group investment funds and unit trusts from 30% to 28%. The lower tax rate applied to these entities, collectively defined as "new company tax rate persons" at the start of the 2011/12 income year.

Sections RZ 3 and RZ 5 outlined modifications to the calculation of provisional tax under the standard method for "new personal tax rate persons" (individuals) and "new company tax rate persons" (companies and certain multi-rate PIEs) for the 2011/12 and 2012/13 income years. For commentary on these modifications, please refer to CCH, *New Zealand Master Tax Guide 2014*.

Residual income tax generally

Residual income tax (RIT) for a tax year is based on:

- the taxpayer's assessment for the preceding tax year, unless the Commissioner has issued a notice of assessment for the tax year at least 30 days before the instalment date, in which case it is based on the Commissioner's assessment for the preceding tax year: see s RC 6(2)
- the Commissioner's assessment for the preceding tax year, whenever the assessment is made, if the taxpayer has failed to file a return by the due date or has been allowed an extension of time for filing under ss 33 and 37 of the Tax Administration Act 1994: see s RC 6(3), and
- the amount of RIT (if any) for the immediately preceding tax year, if the taxpayer is not required to provide a return of income for the preceding tax year or the taxpayer's RIT for that tax year was \$2,500 or less and the taxpayer was not required to provide and has not provided a return of income for that tax year by the date of instalment F of sch 3 for the corresponding income year: see s RC 6(4).

Any increase in RIT resulting from an assessment of a taxpayer's tax liability after the due date for payment of the tax is ignored for provisional tax purposes: see s RC 6(5).

The standard method is not available if any of the other methods are adopted, ie an estimate has been filed, the GST ratio method has been chosen or the Commissioner has determined the amount of provisional tax payable.

¶22-075

Calculation of instalments

Where the standard method is used, s RC 10 provides that the amount of an instalment of provisional tax for a tax year is calculated using the following formula:

$$\frac{\text{residual income tax} \times \text{instalment number}}{\text{total instalments}} - \text{provisional tax}$$

where:

residual income tax is 105% of the taxpayer's RIT for the preceding tax year or 110% of the taxpayer's RIT for the tax year immediately before the preceding tax year or the amount estimated by the taxpayer

instalment number is the number of the taxpayer's instalment for the year (eg 1, 2 or 3)

total instalments is the total number of the taxpayer's instalments for the tax year (eg 1, 2 or 3)

provisional tax is the amount of the taxpayer's provisional tax liabilities for the tax year to date.

If a change occurs to the balance date or cycle of taxable periods of a provisional taxpayer, the calculation of the amount of an instalment is made by applying the updated figures to the items in the formula. See s RC 10(4).

¶22-080 Determining residual income tax following a transitional year [IT07 s RC 20]

Special rules apply for taxpayers whose previous year has been a transitional year. Because provisional tax is calculated on the basis of the previous year's residual income tax (RIT) an adjustment is required to effectively gross up or scale down RIT for the transitional year, until it represents the RIT that would have been applied had that transitional year been of a standard length, see s RC 20(2).

The amount of RIT for the transitional year must be increased or decreased by the amount given by the formula set out in s RC 20(3):

$$\frac{\text{residual income tax} \times \text{days in current tax year}}{\text{days in transitional year}}$$

where:

residual income tax is a person's residual income tax, as applicable—

- for the preceding tax year, uplifted by 5%
- for the tax year before the preceding tax year, uplifted by 10%, or
- the amount estimated by them

¶22-080

No benefit or advantage arises when the benefit is in the form of interest on a loan made at current commercial rates, bearing in mind the nature and term of the loan. For this purpose, the Commissioner uses the current commercial rates published by the Reserve Bank as a yardstick.

¶24-240 Non-business income of charities [IT07 ss CW 41, HC 13, YA 1]

Income derived by the following persons is exempt under s CW 41(1):

- the trustees of a trust for charitable purposes, and
- a society or institution established and maintained exclusively for charitable purposes and not carried on for the private pecuniary profit of any individual.

In addition, the trust, society or institution must be a tax charity (see ¶24-195).

Charitable purposes are defined to include four categories — for the relief of poverty, for the advancement of education, for the advancement of religion and for other purposes beneficial to the community not falling within any of the above categories. See s YA 1 and ¶24-250. However, this list is not exhaustive, and it may well be that another purpose will be acceptable as falling into the general law concept of what constitutes a charity. When a trust has more than one purpose, one of which is non-charitable, charitable status is denied if the non-charitable purpose is not subordinate to the charitable one. However, it is not necessary to show that an organisation is run exclusively for charitable purposes. (See Example 2 below.) A charitable trust enters the tax base when it loses its charitable status.

Example 1:

Of the association of a non-charitable purpose with that of a charitable one, it is well settled that so long as the non-charitable purpose is not an independent purpose but ancillary, subordinate or incidental to a charitable purpose, its presence does not have a vitiating effect. See *C of IR v New Zealand Council of Law Reporting* (1981) 5 NZTC 61,053 (CA). These remarks were later interpreted in a slightly narrower vein to mean that all independent purposes, as well as the fundamental purpose, must be of a charitable nature for the exemption to apply. See *Cowey Mills & Co Ltd v C of IR* (1982) 5 NZTC 61,172; *C of IR v NTN Bearing-Saeco (New Zealand) Ltd* (1986) 8 NZTC 5,039.

Example 2:

Trusts are treated differently and less restrictively than societies and institutions when it comes to the exemption of their income from tax. Although a trust may not itself be exclusively charitable in its establishment, it may still have a separate charitable function. If a segregated part of its income has been received and must be applied exclusively for charitable purposes, then s CW 41 (s CB 4(1)(c) of the Income Tax Act 1994) will apply. See *Latimer v C of IR* (2002) 20 NZTC 17,737 (CA).

The Court of Appeal decision in *Latimer v C of IR* had given rise to an issue of interpretation of s CB 4(1)(c) of the 1994 Act. The wording in issue was:

Any amount derived by trustees in trust for charitable purposes or derived by any society or institution established and maintained exclusively for charitable purposes

There was some debate as to whether or not the words “established and maintained exclusively for charitable purposes” applied to both “societies or institutions” and trusts, or just to “societies or institutions”. The Court of Appeal decision in *Latimer* held that it was the latter. Therefore, trusts do not need to be established and maintained for charitable purposes in order for the tax exemption to apply. It is sufficient that the income is derived by trustees in trust for charitable purposes. This point was upheld on appeal to the Privy Council: *Latimer (Trustees for the Crown Forestry Rental Trust) v C of IR* (2004) 21 NZTC 18,478 (PC). This conclusion is retained in the equivalent provision in the 2007 Act, s CW 41(1), because the income exemption for trusts is in a separate paragraph from the income exemption for societies or institutions.

The trust rules

For the purposes of the trust rules, a trust is a charitable trust in any tax year if the income derived by the trust is accumulated and held in trust solely for charitable purposes.

¶24-240

¶24-250 Public benefit rule [IT07 s YA 1]

Even when the purposes of a trust or organisation fall within any of the heads of charity (ie the advancement of education or religion, or any other matter beneficial to the community), the trust or organisation is not charitable unless it exists for the benefit of the community or an appreciably important section of the community. It cannot exist for the benefit of particular individuals. This is the rule as to public benefit, and it applies in New Zealand.

Example 1:

The Society for the Protection of the Unborn Child was refused recognition as a charitable organisation. An organisation with political purposes is not regarded as charitable because the public benefit rule is not complied with. Political purposes arise not only when the organisation is lobbying for a change in the law, but also when it advocates the maintenance of the existing law. The Court also stated that it was now beyond dispute that the element of public benefit is a necessary prerequisite for valid charitable purposes; at least under the second, third and fourth heads of charity. See *Molloy v C of IR* (1981) 5 NZTC 61,070 (CA). Compare this with *Trustees of the Auckland Medical Aid Trust v C of IR* (1979) 4 NZTC 61,404 (SC). Also consider the Supreme Court decision in *Re Greenpeace of New Zealand Incorporated* (2014) 26 NZTC ¶21-088 where the court held that a blanket political purposes exclusion should no longer apply in New Zealand (see ¶24-195). The Supreme Court in that case concluded that the public benefit rule existed in addition to the requirement for a charitable purpose and rejected the suggestion that benefit to the public presumptively establishes the purpose as charitable.

Example 2:

A trust fell within the criteria established as constituting a trust for the advancement of education. The primary purpose of the trust was to ensure the continuance of education, the fact that parents and the school may gain an advantage was of a secondary nature. The schools were open to any member of the public prepared to meet the fees and expenses and the element of public benefit was therefore present. See *Educational Fees Protection Society Incorporation v C of IR* (1991) 13 NZTC 8,203.

Example 3:

Income derived by the trustees of a fund created for the benefit of retired ministers of the Presbyterian Church was exempt from tax. The benefits conferred on retired ministers were sufficiently connected with the advancement of religion and in sufficient numbers to meet the public benefit element of the charitable purposes test. See *Presbyterian Church of New Zealand Beneficiary Fund v C of IR* (1994) 16 NZTC 11,185. Compare this with *Hester v C of IR* (2004) 21 NZTC 18,421 and *Hester v C of IR* (2005) 22 NZTC 19,007 (CA). Leave to appeal to the Supreme Court was dismissed in *Hester v C of IR* (2005) 22 NZTC 19,194 (SC).

Example 4:

The Medical Council of New Zealand was exempt from income tax on earnings and interest derived from membership levies as it was established exclusively for charitable purposes and was not carried on for the private pecuniary profit of any individual. The council was an instrument of the Executive Government of New Zealand; the Medical Practitioners Act 1968 gave the council responsibilities and powers of a public rather than a private nature; the council did not exist for the benefit of medical practitioners in New Zealand but was established to regulate and control their professional activities; and any benefit conferred on registered medical practitioners by the Act was ancillary to the council's main object. See *C of IR v Medical Council of New Zealand* (1995) 17 NZTC 12,409. This finding was upheld by a Court of Appeal majority. See *C of IR v Medical Council of New Zealand* (1997) 18 NZTC 13,088 (CA).

Example 5:

The New Zealand Education Trust was set up to promote New Zealand as a destination for foreign students. The trust was unique in that it did not have beneficiaries. Rather, it had seven members that consisted of both not-for-profit education providers and private (for-profit) education providers. All education providers paid levies imposed by the Education Act 1989. Some 30% of the levies were paid by the private education providers. While the High Court found that the charitable purpose of the advancement of education did exist, the trust could not be granted charitable status because the public benefit test was not met. The fact that the trust carried out work that benefited both private and not-for-profit education providers called for an examination of whether the benefit provided to the private education providers was more than ancillary or secondary. Charitable status was denied on the grounds that the benefits provided to private education providers could not be seen as merely incidental or ancillary, and therefore the public benefit test was not met. See *Re Education New Zealand Trust* (2010) 24 NZTC 24,354.

See also *Liberty Trust v Charities Commission* (2011) 25 NZTC ¶20-054 at ¶24-195.

¶24-250

and the following apply:

- there is no life interest established by the estate
- no property of the deceased is required by the estate to be held in trust (other than for the period in which the property is subject to administration or executorship), and
- while the administration of the estate is continuing, the net income of the estate is distributed beneficially to the maximum extent that is legally allowable.

In this case, the transfer of property from the administrator or executor to the final beneficiaries is treated as a transfer of property under a relationship agreement. Generally, this means that the property is transferred at the trustee's tax book value.

Assuming all of the other conditions are met, this exception still applies if property that was not in the tax base of the deceased is distributed to beneficiaries who are not within the second degree of relationship to the deceased. See the examples below.

Further, if this exception (and no other exception) applies, there is still a deemed disposal and acquisition at market value when the property that was in the tax base of the deceased is transferred from the deceased's estate to the administrator or executor of the estate. Therefore, this exemption is a partial concession to the asset transfer rules.

Example 1:

Joe (a widower) died on 5 October. Tony is the executor of Joe's estate. Included in the assets in the estate are a residential rental property (the only property in Joe's tax base), \$5,000 cash and a valuable collection of antiques (Joe collected antiques as a hobby when he was alive). The final beneficiaries of Joe's estate are his son, Andy, Joe's niece, Adele, and the Red Cross. Tony makes the final distribution of Joe's estate on 28 March of the following year. Under the terms of Joe's will, Tony distributes the residential rental property to Andy, the \$5,000 cash to the Red Cross and the collection of antiques to Adele. Joe's will does not establish any life interest or require any of Joe's property to be held in trust.

Despite the fact that Adele (a relative of Joe who is not within the second degree of relationship) is included in Joe's will as a final beneficiary, the exception for the final distribution of a simple estate still applies. This is because Andy (a relative of Joe who is within the second degree of relationship) receives the residential property. Accordingly, the transfer of the residential property from Tony to Andy will be made at the tax book value of the estate. Any tax consequences of the transfer will be realised when Andy subsequently disposes of the property.

Example 2:

The facts are as in example 1, except the residential rental property is distributed to Adele and the collection of antiques is distributed to Andy. In this case, the exception will not apply. There will be a deemed disposal and acquisition at market value of the residential rental property distributed to Adele.

Depreciable property

If the exceptions for a distribution to a surviving spouse, civil union or de facto partner or for a simple estate apply (see above), there will be no deemed acquisition at market value of the depreciable property transferred. Instead, there will be a deemed acquisition at either the cost or tax book value of the transferor in accordance with the rules for the transfer of property under a relationship agreement. See s FB 21 and ¶13-580. This gives full effect to the rollover relief provided for in the exceptions.

A person who receives depreciable property by way of a bequest under the asset transfer rules can use the market value of the asset determined in accordance with those rules as the cost base to calculate that person's depreciation loss on the asset.

Example 3:

Jessica inherits a rental property from her great aunt. Jessica decides to keep the property as an investment. Under the asset transfer rules, the transfer of the property from Jessica's great aunt's estate to Jessica is treated as a transfer at market value. The estate must include in its final tax return any depreciation recovery income or depreciation loss arising on the transfer of the rental property. Jessica will be allowed to calculate the depreciation loss on the rental property based on the market value at which it was transferred to her.

See also ¶13-600.

Trading stock

If the exceptions for a distribution to a surviving spouse, civil union or de facto partner or for a simple estate apply (see above), there will be no deemed acquisition at market value of trading stock transferred. As in the case of a transfer of depreciable property, this gives full effect to the rollover relief provided for in the exceptions.

Timber

The transfer of property that is timber, standing timber or the right to take timber is made at tax book value if the property is disposed of to a person within the second degree of relationship to the deceased (for example, the surviving spouse, de facto or civil union partner, children, siblings or grandchildren of the deceased). This applies when the property is transferred from the deceased person to the executor or administrator of the estate and also when the final distribution is made to beneficiaries.

Land

The distribution of land that would have been subject to tax under "the ten-year rule" if it had been sold by the deceased, will not be taxable under that rule, provided the land is distributed to a person within the second degree of relationship to the deceased (for example, the spouse, de facto or civil union partner, children, siblings or grandchildren of the deceased). This applies when the property is transferred from the deceased person to the executor or administrator of the estate and also when the final distribution is made to beneficiaries.

Briefly, "the ten-year rule" is the disposal of land by:

- a land dealer or a land developer within 10 years of acquiring it
- a builder within 10 years of completing improvements to it, or
- a person who has disposed of land within 10 years of acquisition for more than its cost, and at least 20% of the excess received is due to various rules or zoning changes that relate to that land.

If there is no relief from the application of the ten-year rule, a deduction is allowed to the executor or administrator or the final beneficiary for:

- the cost of the land to the deceased person, and
- all other costs incurred by the deceased person and the executor or administrator or the beneficiary that have not previously been deducted.

Financial arrangements

The transfer of a financial arrangement by a deceased estate to the executor or administrator of the estate or on final distribution of the estate is made at cost, provided that the trustee of the estate is a cash basis person. The trustee of an estate can be treated as a cash basis person if the deceased person was a cash basis person at the date of death.

Unexpired prepayments

The transfer of unexpired prepayments by a deceased estate to the executor or administrator of the estate or on the final distribution of the estate is made at cost. The date of the valuation is the end of the income year. See s FC 7.

Savings provisions

There are savings provisions for the past treatment in a tax return in two situations:

- a disposal of property to an administrator or executor or trustee on a person's death, if death occurred before 1 October 2005, and
- a final distribution of an estate to a beneficiary made before 1 October 2005.

The Extradition Act authorises extradition from New Zealand for an offence of a kind that, if committed in New Zealand, would be punishable under New Zealand law by at least 12 months' imprisonment. Tax evasion, for example, is punishable by imprisonment for up to five years so that extradition may be obtainable for tax evasion committed in the requesting state.

The procedures for processing an extradition request vary according to the identity of the requesting state.

New Zealand has concluded extradition treaties with the United States of America, Fiji, Republic of Korea and Hong Kong (Special Administrative Region).

► **Note: Foreign account information-sharing agreement**

On 12 June 2014, New Zealand signed an inter-governmental agreement (IGA) with the United States to clarify the reporting obligations of New Zealand financial institutions under the United States law commonly known as the Foreign Account Tax Compliance Act (FATCA) and also to create specific exemptions from reporting. FATCA requires all foreign financial institutions that are not exempted, including New Zealand financial institutions, to register with and report to the IRS regarding certain financial accounts held with them.

Under the terms of the IGA, New Zealand financial institutions are required to collect information on their customers that are, or are likely to be, United States taxpayers. This information must be sent to Inland Revenue, who in turn will transmit it to United States tax authorities under the existing exchange of information mechanism in the DTA between the two countries. The IGA also provides for reciprocal information to be sent from the United States to Inland Revenue.

New Pt 11B of the Tax Administration Act 1994 was inserted to explicitly authorise financial institutions to obtain and provide to Inland Revenue the information that New Zealand is obliged to obtain and exchange under the IGA. The new provisions deal with concerns that, in the absence of any specific change, financial institutions might not have been able to provide the relevant information to Inland Revenue without breaching the Privacy Act 1993.

The new provisions are generally drafted in a broad manner to accommodate the possibility of New Zealand entering into similar agreements with other jurisdictions in the future.

FATCA requirements take effect from 1 July 2014. Accordingly, this is the effective date for the new provisions.

¶26-285 **Double tax agreements paramount to domestic law**

[IT07 s BH 1(4)]

The fundamental principle relating to double tax agreements (DTAs) is that they are paramount to the domestic law. This means that their provisions have effect notwithstanding the rules contained in the domestic law.

Resources Capital Fund III LP v FC of T 2013 ATC ¶20-386 found that the United States-resident limited partners of a limited partnership formed in the Cayman Islands were entitled to a tax treaty exemption from Australian income tax on share sale profits. The Australian domestic law position of the Cayman Islands limited partnership being deemed to be a company subject to assessment was inconsistent with the exemption available under the Australia-United States of America DTA for the United States-resident limited partners.

The general approach of DTAs is to recognise that the country of residence enjoys the primary right of taxation of a taxpayer engaged in a cross-border transaction. For business profits, the country of residence retains the sole right of taxation unless the non-resident establishes a permanent establishment in the country of source. For dividends, interest and royalties the country of source may tax the income, albeit at limited rates, despite the absence of a permanent establishment in the country of source.

¶26-285

Example:

Japan Co leases barges to NZ Co so that the charter income paid to Japan Co has a New Zealand source. However, Japan Co neither has a permanent establishment in New Zealand nor is deemed to have one. New Zealand may not tax the charter income.

DTAs often provide that the use of substantial equipment in a contracting state under contract is a permanent establishment situated in that state, eg Australia as a state of source may tax charter income from leasing of barges by a Singaporean resident: *McDermott Industries (Aust) Pty Ltd v FC of T 2005 ATC 4398*.

Most DTAs prescribe a lower rate of tax than would otherwise apply under domestic law. For example, royalties paid to residents of Australia and the United States of America are taxed at the rate of 5% rather than the usual 15% rate. Usually any such limitation is expressed to apply to the extent that the payment is at an arm's length level.

¶26-290 **Interpretation of double tax agreements**

New Zealand courts have adopted an approach consistent with that outlined in the 1980 Vienna Convention on the Law of Treaties, to which New Zealand is a signatory. The principles of public international law applicable to treaties, and their interpretation, are codified in the convention. The terms of a treaty are given their ordinary meaning in the context of the treaty and in the light of its object and purpose. The context of the treaty is extended, by art 31(2) of the Vienna Convention, to the preamble, annexes and agreements between the contracting parties.

A double tax agreement (DTA) is part of a network of international agreements using international language, substantially similar in form and effect and designed to promote exchanges of goods and services and the movement of capital and persons in international trade by eliminating international double taxation. "The OECD Convention rules have an international currency used as they are by and in countries throughout the world and accordingly the language of the rules should be construed on broad principles of general acceptance and having appropriate regard to the Commentary and any travaux préparatoires": *C of IR v JFP Energy Inc (1990) 12 NZTC 7,176*.

Generally a private or public ruling is not available for DTA matters: see QB 08/03, "Application for a private ruling or product ruling on an issue dealt with in a mutual agreement made under a double tax agreement — Tax Administration Act 1994, sections 91E(4)(d)(ii) and 91F(4)(d)", *Tax Information Bulletin* Vol 20, No 7, August 2008, at 20.

DTAs have ambulatory and not static meaning so that a DTA may prevent the imposition of the capital gains tax introduced after the contracting states entered into the DTA: *Undershaft No 1 Ltd v FC of T 2009 ATC ¶20-091*.

¶26-300 **Meaning of "permanent establishment"**

Where a non-resident has a "permanent establishment" (PE) in New Zealand and the business profit is attributable to the PE, the relevant double tax agreement (DTA) will provide that the non-resident entity is subject to tax in New Zealand. (The reverse also applies: New Zealanders conducting business overseas will not have their business income taxed by an overseas Government if a relevant DTA exists, so long as they do not have a PE overseas.)

A PE generally means a fixed place of business through which the business of an enterprise is wholly or partly carried on and is usually based on art 5 of the OECD Model DTA. This includes a place of management, a branch, an office, a factory, a workshop, a mine, a quarry, an oil or gas well, and an agricultural, pastoral or forestry property. The concept of permanency appears to underlie the meaning of a fixed place of business. Activities that are merely preparatory and that are auxiliary to a place of business — for example, using facilities for the storage, display or delivery of goods or merchandise — do not come within the ambit of a PE.

¶26-300

account in determining income. The self-assessed cost scheme is an alternative cost option. The main variation between the national standard cost scheme and the self-assessed cost option is that self-assessed costs use a farmer's own costs of production, while national standard costs use nationally provided average costs. The main features of the national standard cost scheme are as follows:

- The scheme is based on national average costs of production.
- Homebred stock are valued using national average costs for breeding, rearing and growing.
- A national average rearing and growing cost will be added to homebred rising two-year stock.
- Except for rising three-year male non-breeding stock, no rearing and growing costs will be added beyond homebred rising two-year stage. Costs are accumulated to maturity (generally rising two-year stage) and are held at that level within an inventory system until the stock is disposed of (ie the cost of an animal will remain constant for its mature life).
- An inventory system is required for mature mixed-age classes to calculate closing inventory value under national standard cost. The minimum standard of an inventory system is the average cost inventory system. More complicated alternatives are specific identification and first-in first-out (FIFO) costing.
- All purchased livestock are taken into account at actual purchase price.
- The average of homebred costs and purchase costs is applied to stock on hand at year's end to derive a closing value.
- Free movement between national standard cost, market value or replacement price on an inventory grouping basis is allowed, but a two-year notice period is required for movement between national standard cost and self-assessed cost. See further at ¶27-295.
- The national standard cost scheme can be used in conjunction with the herd scheme.

See ¶27-267.

Self-assessed cost

The self-assessed cost option is based on farmers assessing their own costs according to guidelines issued by the Commissioner of Inland Revenue. The national standard cost scheme uses national average costs of production. The self-assessed cost guidelines use livestock units (a well-accepted unit based on feed intake) to apportion farm costs between livestock types. The apportioned costs are accumulated to determine the cost of livestock production in a year. The main features of the self-assessed cost option are as follows:

- Self-assessed cost is an alternative to national standard cost for persons who wish to assess their own costs.
- Persons cannot use the self-assessed cost option and the national standard cost scheme in the same income year. Any change from the self-assessed cost option to the national standard cost scheme requires two years' notice. See further at ¶27-295.
- The rules governing the self-assessed cost option are not contained in legislation but are set out in guidelines issued by Inland Revenue. See *Tax Information Bulletin* Vol 4, No 7, March 1993, Appendix A.

See ¶27-268.

Other areas covered by the livestock valuation provisions

The other areas covered by the livestock valuation provisions are: high-priced livestock; non-specified livestock; movement between schemes; and income equalisation and adverse event provisions.

¶27-235

High-priced livestock

Livestock that qualifies as "high-priced livestock", as defined in s YA 1, must be valued under the provisions governing this type of livestock. The high-priced livestock scheme applies only to livestock costing \$500 or more. The purchase price must also be at least five times the greater of the national average market value for the relevant livestock class for the income year in which the animal is purchased and the national average market value for the same livestock class for the immediately preceding income year. Straight-line or diminishing value depreciation is available at the person's option. Once animals have been depreciated to the national average market values, they must be removed from the high-priced regime and valued under one of the other options.

See ¶27-290.

Non-specified livestock

Non-specified livestock (eg rabbits, opossums, emus, alpacas, and horses that do not come within the definition of "bloodstock" (see ¶27-300)) is valued under:

- the market value option
- the replacement price option
- the cost price option, or
- if the Commissioner agrees, the standard value option.

See ¶27-280.

Movement between schemes

The main features of the rules governing movement between schemes are as follows:

- There is free movement from the national standard cost or from the self-assessed cost scheme to the market value or replacement price schemes.
- A person can move animals to the herd scheme at any time on an animal-by-animal basis; this applies to the adoption of the scheme and to progressive movement of stock numbers or classes to the herd scheme.
- Any increase in stock numbers in any herd class valued under the herd scheme can be valued under an alternative valuation option provided a minimum number is valued under the herd scheme.
- In some cases, written notice of an election to change valuation methods must be given.
- A person cannot use both the national standard cost and self-assessed cost in the same year.
- An election to use the herd scheme is irrevocable, with limited exceptions.

See ¶27-295.

¶27-260 Specified livestock [IT07 s YA 1, sch 17, sch 18]

There are six different types of specified livestock. These are sheep, beef cattle, dairy cattle, deer, goats and pigs. These types are set out in column 1 of sch 17 of the Income Tax Act 2007, together with the various classes into which those types of specified livestock are divided (column 2). These classes of livestock are referred to in all valuation methods.

For the purposes of the national standard cost scheme, livestock are also classified into categories and inventory groupings:

- There are 16 categories of livestock. These are the categories for which national standard costs are declared annually for the purpose of the national standard cost scheme. These categories are set out in sch 18.
- There are two inventory groupings referred to in the national standard cost scheme. These are: rising one-year stock, and mature stock (which includes rising two-year stock).

¶27-260

¶29-220 Automatic enrolment

[KIW ss 40-43]

From 1 July 2007, every employer in New Zealand is required to automatically enrol all new eligible permanent employees into a KiwiSaver Scheme on the day they commence employment. Eligible employees are New Zealand citizens aged between 18 years and the age of eligibility for New Zealand Superannuation (currently 65).

Employers must ask all new employees if they are already a KiwiSaver member. If they are not, the employer must give the employee a KiwiSaver information pack within seven days of starting work. These information packs contain all the necessary information for employees to be able to make a decision regarding their participation in KiwiSaver. The information packs must also be given to any employees who opt in to KiwiSaver or who request a pack because they are considering opting in.

Employers must provide Inland Revenue (IR) with the names, tax file numbers, and address of all employees who are automatically enrolled or who opt in to KiwiSaver.

An employer who has selected a preferred KiwiSaver provider must also supply employees with:

- an investment statement for that scheme, and
- notification that, if employees do not choose their own scheme, they will be allocated to the employer's chosen scheme (and not to one of the default KiwiSaver schemes).

The automatic enrolment rules do not apply if an employee is already a member of a KiwiSaver scheme. However, a person may only be a member of one KiwiSaver scheme at a time. This means that, when an employee changes employers, contributions deducted by the new employer must be paid via IR to the member's existing KiwiSaver scheme, or to a new scheme if the member wishes. If the member selects a new scheme, savings in the original scheme will be transferred to the new KiwiSaver scheme. This is achieved by the new KiwiSaver scheme provider providing notification to the existing provider and to IR.

¶29-225 Opting out

[KIW ss 17-21]

Opting out

An employee who is automatically enrolled in KiwiSaver can choose if they want to stay with KiwiSaver, or opt out. The opt-out period for employees runs from the end of week two of their employment to the end of week eight. Up until the time the employee opts out of KiwiSaver, contributions to KiwiSaver will be made. To opt out the employee must provide Inland Revenue (IR) or the employer with an opt-out notice (form KS 10, "New employee opt-out request"). The notice is effective from the date it is accepted by IR or received by the employer, as the case may be. In practice, the employee can complete and return the form during the first two weeks, but it will not be actioned by IR until the end of the second week. Form KS 10 is contained in the KiwiSaver employee information pack given to all new employees on their start date. See ¶29-220.

For the purposes of ss 17-20 of the opt-out rules a PAYE intermediary is treated as an employer.

Late opt-outs

Late opt-outs will only be accepted at the Commissioner's discretion if one or more of the following applies:

- the employer did not supply the employee with an information pack within seven days of the employee starting new employment
- IR did not send an investment statement for the default KiwiSaver scheme to which the employee was allocated

¶29-220

- the employer did not supply an investment statement for the employee's chosen KiwiSaver scheme, if the employer had a preferred scheme provider in place
- events outside of the employee's control meant that the opt-out notice could not be given within the time limit for opting out and, in the opinion of the Commissioner, it is reasonable that a late opt-out notice be accepted, or
- a mistake has occurred and the person does not meet the requirements.

The Commissioner may accept a late opt-out notice if it is received by the Commissioner or employer up to three months after the date when IR receives an employee's first contribution. If a late opt-out notice is received and the Commissioner does not accept it, the notice will be treated as if it were an application for a contributions holiday, if the person is eligible to apply for one. See ¶29-245. A contributions holiday in lieu of a failed opt-out is usually granted for five years. If a contributions holiday is granted in lieu of an opt-out, IR will not notify the employer named on the opt-out request.

IR has issued a standard practice statement SPS 07/04, "Discretions to be exercised by the Commissioner of Inland Revenue under the KiwiSaver Act 2006", which sets out the Commissioner's practice in exercising some of his discretions under the KiwiSaver Act 2006, eg accepting or declining late opt-outs or applications for contributions holidays. SPS 07/04 was published in *Tax Information Bulletin* Vol 19, No 6, July 2007 at 10.

¶29-230 Contributions to KiwiSaver

[KIW Pt 3, subparts 1, 3A, s 4(1)]

An employer is required to deduct contributions from an employee's gross wages or salary on the first payday after the employee starts work. Unless the employee elects to go on a "contributions holiday" (see ¶29-245), contributions will continue until the employee leaves service.

Employer contributions are subject to employer's superannuation contribution tax (ESCT) and from 1 April 2012, ESCT is required to be deducted from employer contributions made to a KiwiSaver scheme. An exemption from ESCT for employer contributions applied up until 31 March 2012. See ¶29-420.

Member contributions

The standard contribution rate for employees to KiwiSaver is 3% of an employee's gross salary or wages (from 1 April 2013), with an option to contribute at a higher rate of 4% or 8%. Gross salary or wages means "salary or wages" before deduction of tax. "Salary or wages" is given the same meaning in the KiwiSaver Act 2006 as in s YA 1 of the Income Tax Act 2007 except that redundancy payments are excluded as are the value of housing or living allowances or benefits.

Extra pays are included in the KiwiSaver definition of "salary or wages" unless otherwise excluded or the amount of the extra pay is a redundancy payment. Parental leave payments and payments of compensation under the accident compensation legislation are also included, except when calculating the amount of an employer's compulsory contribution (see below).

If an employee selects any other rate on his or her KiwiSaver deduction form (KS 2), or does not select a rate, deductions must be made at the default rate of 3%.

Example:

Linda joined NZ Co in November 2014. She earns \$500 per week before tax and other deductions. She has not opted out of KiwiSaver and has not given NZ Co notice requiring contributions at the higher rate of 8%. Using tax code "M", PAYE would be \$77.15 with KiwiSaver contributions of \$15 per week (3%). Linda's net pay would be \$407.85 (\$500 - \$77.15 (tax) - \$15 (KiwiSaver contribution)).

Inland Revenue (IR) provides KiwiSaver contribution calculations in the PAYE deduction tables (IR 340 and IR 341) and PAYE payroll specifications for employers to use.

¶29-230

to certain decisions of the Commissioner and to assessments. Also, a registered person is liable to pay interest and late payment penalties if GST is not paid by the due date. He or she must keep full and appropriate records establishing that person's liability for the tax and is to advise the Commissioner of certain events, ie give notice to the Commissioner within 21 days of any change of address or ceasing to carry on a taxable activity. Cancellation of registration does not relieve a registered person of the obligation to meet pertinent GST responsibilities.

Special status registration

Special registration principles apply to the following individuals and groups:

- groups of companies
- groups of persons
- branches and divisions of a registered person
- unincorporated bodies, partnerships, joint ventures and trusts, and
- personal representatives, liquidators, receivers and mortgagees in possession.

See ss 55–58 of the GST Act and ¶32-130, ¶23-110 and ¶23-115.

Registration for non-residents

With effect from 1 April 2014, non-residents that are not making taxable supplies in New Zealand may be able to register under a new provision, s 54B. Currently non-resident businesses that are not carrying on a taxable activity in New Zealand may still need to bear New Zealand GST as an economic cost of doing business. The new provision allows non-resident businesses to register and claim input tax deductions in broadly the same manner as comparable New Zealand businesses.

For a non-resident person to be registered under s 54B, the Commissioner must be satisfied that the person is not liable to be registered under the ordinary registration rules and that:

- the person is registered for a consumption tax in the territory in which they are residing, or, if that territory does not have a consumption tax, the person is carrying on a taxable activity in that territory that would make them liable to be registered in New Zealand if they were carrying it on here
- the person's input tax claim for their first taxable period after registration is likely to be more than \$500
- the person's taxable activity does not involve a performance of services where it is reasonably foreseeable that the performance of the services will be received in New Zealand by an unregistered person, and
- the person is not carrying on, or intending to carry on, a taxable activity in New Zealand, and is not, and does not intend to become, a member of a group of companies carrying on a taxable activity in New Zealand.

If a non-resident registered under s 54B starts making taxable supplies or becomes a member of a group of companies making taxable supplies, they will be treated as not registered from that date.

See *Tax Information Bulletin* Vol 25, No 9, October 2013 at 33.

Bodies corporate

On 8 May 2013, Inland Revenue released an issues paper, IRRUIP 7, "Bodies corporate — GST registration", discussing the GST treatment of bodies corporate registered under the Unit Titles Act 1972 or the Unit Titles Act 2010. The paper was in response to inquiries about whether a body corporate carries on a taxable activity and can be registered for GST. The issues paper set out a tentative interpretative position for consideration and also raised some alternative views, inviting submissions from interested parties on both the legal position and the appropriate policy outcome.

¶32-148

The Commissioner's preliminary view was that a body corporate makes supplies of services to owners of a unit title. Further, those owners provide consideration for those supplies in the form of body corporate levies. By making such supplies for a consideration a body corporate carries on a taxable activity. Consequently, a body corporate that makes supplies that exceed the \$60,000 threshold is liable to be registered for GST. Similarly, a body corporate that makes supplies below the threshold may voluntarily register for GST. The reasons for this view were set out in detail in the issues paper. However, the conclusion reached was not entirely free from doubt.

Many submissions on the issues paper raised policy arguments on why bodies corporate should not be required to register for GST. In response to these submissions, and because of concerns about the potential compliance costs that could arise under the proposed interpretation, the Government decided to change the law so that it aligns the GST treatment with past operational practice and the GST treatment of other private homeowners. The Government's proposed new rules are set out in a Discussion Document, "GST treatment of bodies corporate", released in June 2014. These include:

- a GST exemption for goods and services that a body corporate provides to its unit owners under the Unit Titles Act 2010
 - a "look-through" rule to allow GST registered unit owners to claim back GST on supplies provided to the body corporate by third parties (such as insurance) to the extent to which these relate to the unit owners' taxable activity, and
 - a "savings" provision and date-of-registration rule that apply to bodies corporate that registered for GST before 6 June 2014 (the date the proposed changes were announced).
- The GST exemption should generally prevent bodies corporate from registering for GST because they will not carry on a taxable activity in relation to their exempt supplies to unit owners. Those bodies corporate already registered will become de-registered as a result of the proposed exemption. The "savings provision" would apply to bodies corporate currently registered for GST so that they would apply the new exemption from 6 June 2014 and apply the existing law for earlier periods. The date-of-registration rule would apply to bodies corporate that registered for GST on a date between 1 April 2010 and 6 June 2014, and who would also be covered by the savings provision. These bodies corporate may elect to be treated as being registered for GST from the later of:
- the date of their first taxable period beginning after 1 April 2010, or
 - the date they first became liable to be registered for GST under s 51(1).

The "look-through" rule would treat any supplies that are received by the body corporate (such as insurance or maintenance) to be provided directly to the underlying owners in proportion to each unit owner's ownership interest in the body corporate. It would apply to supplies made after 6 June 2014.

Suggested draft legislation is included in an Appendix to the Discussion Document. The Government intends to introduce amendments to the GST Act in the next available taxation bill.

¶32-149 Cancellation of registration

[GST ss 5(3), (3B), 10(7A), (8), 16(4), (5), 51(1), 52, 53, 54C]

Registration can be cancelled if a registered person:

- ceases to carry on all taxable activities, or
- ceases to be liable to be registered (that is, the projected value of that person's taxable supplies in any year to come does not exceed \$60,000).

De-registration triggers an output tax liability on assets held within the GST taxable activity.

¶32-149

be effective it is necessary for the assignor to relinquish all control over the income. If any power remains to defeat the effect of the assignment, it cannot be said that he or she has assigned the income so that it no longer forms part of the transferor's assessable income. In this context it is the power to defeat the assignment which is important and not whether the power has been exercised.

¶33-250 Meaning of right to income

It is necessary to draw a distinction between the assignment of an existing right to income and the assignment of an expectancy or possibility of becoming entitled to income in the future. A currently existing right to income is an existing chose in action which is capable of assignment: *Hadlee and Sydney Bridge Nominees Ltd v C of IR* (1991) 13 NZTC 8,116 (CA). This right may be assigned legally or equitably, whether or not for consideration. A mere expectancy or a possibility of becoming entitled to income is, on the other hand, incapable of assignment without consideration and in some cases not even then.

¶33-260 Temporary settlement of property

In some cases, a taxpayer may attempt to achieve short-term tax savings by temporarily transferring the income-producing property to another. During the period of transfer the income arising from the property forms part of the assignee's income. At the end of the period of transfer the property reverts to the assignor, who would recommence to derive income from it.

The provision relating to short-term assignments, s FC 11 of the Income Tax Act 1994, was repealed with effect from 1 April 1998. See ¶23-175 for discussion of the common-law principles which apply from that date.

¶33-270 Recipient of diverted income

The essence of diverting income for tax purposes is to have it diverted to a non-taxpayer or a taxpayer whose rate of tax is lower than that of the person who would otherwise derive the income. However, the transferee must also be the person associated with the taxpayer or a person to whom the benefit of the income would in any event have passed, such as a dependant. The choice of the recipient of income may well call for as much skill and judgment on the part of the tax planner as the method of achieving the income diversion itself.

Among considerations which must be taken into account, apart from comparative tax costs, are the possibility of legislative changes, asset planning implications, the degree of sophistication of the taxpayer, the taxpayer's appreciation of the legal implications and general understanding of the nature of the vehicles that might be employed, and the benefit to the taxpayer personally of having the income diverted to the new recipient.

¶33-285 Mass-marketed tax schemes [IT07 ss GB 45-GB 48]

In 2002 the Government became concerned at the proliferation of mass-marketed tax-driven schemes which allowed investors to obtain tax benefits far in excess of the amounts invested. These schemes were typically based on films, forestry and intellectual property transactions involving contingent loans used to acquire assets which were difficult to value. The participants in the schemes received tax benefits regardless of the success of the schemes.

Sections GB 45-GB 48 of the Income Tax Act 2007 were enacted to counter this activity. These provisions generally apply from the start of the 2004/05 income year, although certain transactions entered into before that year are also affected.

Broadly, taxpayers and their associates who are parties to, or affected by, certain arrangements involving limited recourse loans must defer the deductions which arise from those arrangements. This "deferred deduction" rule is activated when the total cost of property held by the taxpayer under the arrangement satisfies within prescribed criteria.

For a more detailed discussion, refer to ¶10-061.

¶33-250

ATTRIBUTION OF PERSONAL SERVICES INCOME

¶33-325 Attribution rules for personal services income

[IT07 ss DC 8, GB 27-GB 29, YA 1]

There are specific anti-avoidance rules in ss GB 27-GB 29 which prevent higher income earners from diverting personal services income to other associated entities such as companies, trusts and look-through companies (LTCs). The policy intention is to ensure that these taxpayers cannot avoid the highest personal tax rate (currently 33%). The attribution rules apply to the 2000/01 income year and subsequently.

In September 2011, Inland Revenue (IR) published Revenue Alert RA 11/02 which sets out IR's concerns in relation to taxpayers structuring their affairs in order to divert personal services income to take advantage of lower marginal tax rates and reduced child support or student loan obligations. The Commissioner considers that some such arrangements may constitute tax avoidance, and the Revenue Alert describes the factors the Commissioner will take into account when reviewing these arrangements and the case law she considers relevant. Revenue Alert RA 11/02 replaced Revenue Alert RA 10/01 (June 2010) and updates the Commissioner's view following the Supreme Court decision in *Penny and Hooper v C of IR* (2011) 25 NZTC ¶20-073.

Under the attribution rules, the amount of income that is derived by the associated entity of a taxpayer who provides personal services is attributed to that taxpayer, after the deduction of allowable expenditure. The amount attributed is deductible to the associated entity in the income year in which the amount is attributed.

These rules apply purely for the purposes of income tax. The parties' transactions remain unaffected in other legal or commercial contexts.

Application of the attribution rules

The attribution rules apply when a taxpayer who earns income from personal services (the working person) inserts an associated entity between the working person and the party purchasing those services. The buyer of the services deals with the associated entity, which derives the income arising, but it is the working person who actually provides the services. Subject to prescribed criteria, the interposed associated entity must attribute an amount to the working person under s GB 29.

Attribution to the working person is required when the services are purchased and provided from different persons as noted above, and the following criteria are satisfied:

- 80% or more of the associated entity's total assessable income from personal services during the income year is derived from the sale of services to the buyer of the services or an associate of the buyer
- 80% or more of the associated entity's total assessable income from personal services is derived through services personally performed by the working person or his or her relative (the test for a relative, discussed below, is applied at the beginning of the purchaser's income year)
- the working person's net income for the income year exceeds \$70,000, including any amounts available for attribution (for this purpose, income includes a fringe benefit from an associate of the working person), and
- substantial business assets (as defined) are not a necessary part of the business structure used to derive the associated entity's assessable income.

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