¶1-190 The derivation of income [IT07 s BD 3]

Income tax is an annual tax imposed on a person's taxable income for each year. This means that it is necessary to determine for which year income (and deductions) should be allocated. See ss BD 3 and BD 4. Unless the amount of income is subject to a timing regime under Pt C or Pts E–I, income is allocated to the income year in which it is derived. See s BD 3(2). At first glance, there would seem to be no difficulty with this, because the year's income is simply the total of all income items actually received by the person during the year. So long as the person can add up all salary payments, interest and dividends, etc, between 1 April and the following 31 March, there would seem to be no room for doubt. However, it is not always obvious when many types of income are derived.

Example 1:

A payment of salary is made by an employer into a bank account of an employee. Later the employee takes the money out of the account and uses it. In this case, the salary is derived when paid into the account, not when the employee later takes it out. See s BD 3(4).

Example 2:

A business person carries out the business of manufacturing products and selling them. This is a continuous process. Each 31 March there is a notional line drawn and it must be decided what income has come from the business in the year up to that date. If the business has recently sent out a batch of products and billed the customer so that the customer owes the person the price of the products, is that amount to be regarded as income of the person at the time when it becomes owing, or only when it is actually paid? If the former, it would be income in the year just ended but, if the latter, the customer might not pay the bill until the next year has started and so it would become part of the income of the next year.

When income is derived is generally based on ordinary accounting principles. Business accounting operates on an accrual system whereby items are regarded as income when they become owing, not when they are actually paid. This is the approach adopted for income tax purposes in the type of case outlined above. There are a number of rules in the Act for determining when particular types of receipt are derived, as well as much case law developed on this question. See ¶5-075. The issue is important, because the allocation of income to one particular year instead of another often affects not only the time at which the person must pay tax on it but also the amount of the tax to be paid.

DEDUCTIONS

¶1-220 Deductions defined [IT07 ss BD 2, DA 1, DA 3]

A person's tax liability is calculated by determining all assessable income for a particular income year (annual gross income) and subtracting from that figure all deductions for the year (annual total deductions). Only those deductions which are expressly authorised by the Act may be made in calculating a person's tax liability. If a taxpayer wishes to claim a particular deduction, the taxpayer must be able to point to a provision in the Act that allows it.

General permission

Briefly, the general permission provides that an amount of expenditure or loss is deductible to the extent to which it is:

- incurred in deriving the taxpayer's assessable income or excluded income or a combination of those types of income, or
- incurred in the course of carrying on a business for the purpose of deriving assessable income or excluded income or a combination of those types of income.

A taxpayer is also allowed a deduction for an amount of depreciation loss, provided one of the above criteria is met.

In order for expenditure or losses to be allowed as a deduction, they must relate directly to the derivation of assessable income, excluded income or a combination of both.

Example:

If a taxpayer derives income from rents, he or she is allowed a deduction for the expenses incurred in deriving that income, such as rates on the premises, maintenance, depreciation and outgoings.

For a deduction to be allowed as being incurred in the course of carrying on a business, the expenditure or loss must relate directly to the business but need not necessarily relate to any particular item of assessable or excluded income. It is only necessary that the person shows that the business in which the expenditure or loss was incurred was carried on for the purpose of deriving assessable or excluded income. See ¶10-021.

There are a number of general limitations which restrict the general permission (see ¶1-221) and other more specific rules which may supplement or override the general permission (for example, deductions for taxes, revenue account property, bad debts and research and development).

Section DA 3 clarifies the effect of a specific rule on the general permission and the general limitations; see ¶10-016.

Loss

The reference to "loss" (as well as "expenditure") in the general permission is designed to cover the situation where no actual expenditure is incurred by the taxpayer but the taxpayer suffers a loss. The writing off of a bad debt, for example, involves no expenditure of the amount written off, but that amount could be described as a loss. A distinction is made between this type of loss and loss as in the context of a negative result from a year's trading. The core provisions have distinguished the two terms by including a reference to "net loss" — applicable where the result of the income calculation is a negative figure.

¶1-221 Summary of general limitations for deductions [IT07 s DA 2]

No deduction is allowed for an amount of expenditure or loss to the extent that it is:

- of a capital nature (the capital limitation)
- of a private nature (the private limitation)
- incurred in deriving exempt income (the exempt income limitation)
- incurred in deriving income from employment (the employment limitation)
- incurred in deriving non-resident passive income (the withholding tax limitation)
- incurred in deriving non-residents' foreign-sourced income (the non-residents' foreign-sourced income limitation).

The general limitations override the general permission (see ¶1-220).

The most important general limitation is the capital limitation. See ¶10-071. Many cases have involved argument over the question of whether particular types of expenditure were of a capital nature and therefore not allowed as a deduction. See, for example, *Auckland Gas Co Ltd v C of IR* (2000) 19 NZTC 15,702 (PC).

¶1-250 Employment expenses [IT07 ss DA 2(4), DB 3, YA 1]

Apart from those expenses incurred in determining a person's tax liability (ie for the preparation of income tax or GST returns under s DB 3(1)) certain loss of earnings and/or profits, insurance premiums and expenses relating to the derivation of income subject to withholding tax, no other deduction is allowed in deriving income from employment. However, independent contractors (eg real estate sales persons) who do not derive any "income from employment" can still deduct expenditure incurred in deriving assessable or excluded income.

Other deemed matters

As income statements are deemed returns and deemed assessments, s 80I of the Tax Administration Act generally provides that the statements cannot be challenged on the grounds that a return has not been filed, or a person has not filed or signed a return, or that an assessment is not final. Similarly, anything required to be done or provided within the time limit for filing a tax return is deemed to be required to be done or provided within the time limit for responding to an income statement.

¶2-035 Filing requirement for a non-resident

An individual who is regarded as non-resident for New Zealand income tax purposes must file a return of income (IR 3NR) showing all income derived from New Zealand. The exception is if non-resident withholding tax (NRWT) was imposed on that income and that tax is treated as a final tax (not all forms of NRWT tax are a final tax). The tax position relating to a non-resident is more fully described beginning at ¶26-400.

If an individual is a New Zealand resident for income tax purposes for part of the tax year, the individual is required to file only an IR 3 (resident return) for the year.

¶2-036 Agents and returns [IT07 ss HC 32, HD 3, HD 4, HD 6, HD 9–HD 15; TAA s 34]

Filing requirements

An agent may be required to furnish a return, make an assessment and satisfy all tax liabilities on behalf of a principal. The Commissioner may treat a relationship between two persons engaged in business as a principal and agency situation. This might arise through either overseas or local control of a New Zealand business actually conducted by another. Agency status for tax purposes is attributed in the following circumstances:

- A guardian or a manager of a person under disability. See s HD 9.
- A mortgagee in possession of income derived on behalf of a mortgagor. See s HD 10.
- A nominated company in respect of a consolidated group or an imputation group. See s HD 11.
- A trustee for income of beneficiaries (excluding a beneficiary of a community trust). See ss HC 32 and HD 12(1).
- A settlor of income tax payable by the trustee. See ss HC 29 and HD 12(2).
- A trustee of a unit trust in relation to income of the unit trust. See s HD 13.
- A debenture company in respect of income derived by debenture holders. See s HD 14(1). In practice, however, a debenture company is able to avoid agency tax responsibilities for resident debenture holders by supplying the Commissioner with the certified list provided for by s HD 14(2)–(6).
- A reconstituted company for outstanding tax of the original company. See s HD 15.

With the Commissioner's agreement, a principal and an agent may agree that the principal will furnish a return that the agent would otherwise be required to furnish (and make an assessment and satisfy any income tax liability the agent would otherwise be required to meet). See s HD 4.

Sections HD 18–HD 29 deal with agents for absentees and non-residents.

Signing returns

A person need not personally fill out and sign the person's own return. When a return is made by or on behalf of any person, it is deemed to have been made by the person or on the person's authority unless the contrary is proved. See s 34 of the Tax Administration Act 1994. The Commissioner will not accept a return signed by an agent if there is an added disclaimer attached, although she will have no objection to the addition of a disclaimer to the statement of financial position of unaudited financial statements.

With regard to tax agents signing tax returns on behalf of clients, see Inland Revenue newsletter *AGENTS Answers*, Issue 54, February 2004.

¶2-037 Maori authority returns [TAA ss 57, 68B, 69B, 70B]

A Maori authority is required to furnish an income tax return, a distribution statement containing details of all distributions made for the year and a Maori authority credit account return.

¶2-050 Returns of partners, trustees and others [TAA ss 42, 43(2), 43A(7), 44, 44A, 79, 80]

Partners and partnerships

Persons in partnership are required to make a joint return of their partnership income, and each partner must also make a separate return of the income derived from the partnership and from other sources. For these purposes, the partnership should complete form IR 7 and each individual partner should also complete form IR 3. See ¶2-015. A person deriving income from a joint venture, other than as a partner, must individually return his or her share of that income.

Trustees

A trustee is required to annually furnish a return of income derived as a trustee of a trust. Separate returns must be made when a person is trustee of more than one trust, even if the beneficiaries under those trusts are identical. Co-trustees must make a joint return of the income of the trust. However, it is Inland Revenue (IR) policy that a trust that derives no income or has no tax obligations is not required to file a tax return. See IR's newsletter, *AGENTS Answers*, Issue 31, March 2002 and *AGENTS Answers*, Issue 66, February 2005.

Special returns

The Commissioner also has power to require any person to make a return considered necessary for the purposes of the Act. The Commissioner may require a return to be made relating to a particular transaction or transactions or for any particular period, from an agent, a non-resident trader, a person who is believed to be about to leave the country or is discontinuing business or has ceased to derive income or is bankrupt, a company that is in liquidation, or the executors or administrators of a deceased estate in relation to the deceased's taxable income for his or her lifetime. The Commissioner also has the power to require a non-active company to file a tax return or an imputation return. These powers are not often used, but may be when the Commissioner considers that returns of income will not be made in the normal way.

Special returns are required from a person whose taxable income or loss for the tax year is reduced by, or affected by a reduction in, the amount of a deduction under s DT 2 (arrangement for petroleum exploration expenditure and sale of property) or s DS 3 (clawback of deductions for film reimbursement schemes) of the Income Tax Act 2007.

The exemption applies to resident and non-resident contractors and resident and non-resident entertainers. The exemption will continue until the Commissioner varies or revokes the determination.

Example 5:

Bill has been contracted by a local film production company as an ''extra'' for the filming of a short documentary. The documentary is being filmed at various locations around New Zealand. When filming is taking place out of Bill's normal town of residence, Bill is paid a daily allowance of $80 per day. No other goods or services are provided to Bill. Withholding tax must be deducted from $20 per day of the allowance paid ($80 allowance less $60 exemption).

Example 6:

Judy is a freelance make-up artist specialising in film and television make-up. Judy has secured a contract to provide her services for the filming of a local music video. The video will be filmed out of Judy's normal town of residence. Judy will be provided with meals while on the contract. The cost of these meals will be $20 per day. In addition, Judy will receive a daily allowance of $50. Withholding tax must be deducted from $10 per day of the allowance paid ($50 – ($60 – $20)).

The amount of daily allowance paid must be included in the employer monthly schedule as part of gross earnings and/or schedular payments, even if no withholding tax has been deducted. See Inland Revenue newsletter, *Payroll News*, Issue 56, September 2003.

Example 7:

A contractor has been paid $1,550 for one day's work, and a daily allowance of $55. Withholding tax (at 20%) of $310 has been deducted from the $1,550. Because the allowance paid is less than $60, no withholding tax has been deducted from this payment. On the employer monthly schedule, the gross amount of schedular payment is shown as $1,605 and the withholding tax is $310. When the contractor files her tax return at the end of the year, the $55 allowance can be claimed as an expense.

¶3-460 Inducement payments [IT07 ss CE 1(1)(g), CE 10]

An inducement payment can be made by an employer to encourage a particular person to either enter employment (a ''golden hello'') or to remain in employment (a ''golden handcuff''). These types of payments are generally subject to tax at source on the basis that they are employment income.

Section CE 1(1)(g) includes as employment income ''any other benefit in money''. This section can be regarded as a ''catch-all'' for any unusual or extraordinary receipts arising in connection with an employee's employment.

Example 1:

C of IR v Kerslake (2001) 20 NZTC 17,158 concerned an employee who received a retention incentive payment, following his agreement not to resign from his position with an employer gradually winding down its New Zealand operations. The High Court agreed with the Commissioner that the retention payment was an emolument or other benefit in money related to the employment or service of the taxpayer. The payment was solely referable to the continued rendering of services. The High Court rejected the taxpayer's contention that the payment was effectively a restraint of trade payment because he became unable to resign and seek a fresh position.

Exit inducement payments

Exit inducement payments are sometimes paid by a prospective employer to an employee to induce them to leave their existing position and accept a new position. As an inducement, the employee may be compensated for giving up a vocation or for a change in status. The payments are usually made at the beginning of the employment relationship or, in some cases, even before the employment relationship commences. The payments may be non-refundable. Section CE 10 deems any amount derived by a person for loss of a vocation, position or status, or for leaving a position, to be income.

The section is intended to be broad enough to cover not only employment positions but also contracts for services or an office such as a board membership. It is also intended to be wide enough to cover in-kind payments as well as monetary payments. However, s CE 10 is not intended to apply to payments genuinely made in respect of humiliation, loss of dignity or injury to feelings relating to employment disputes. See ¶3-468.

Example 2:

A barrister is paid $10,000 by a client to induce him to leave his practice and become an employee of the client's company. The payment is to compensate the barrister for the loss of his professional status. Under s CE 10 the payment is taxable income of the barrister.

Inducement payments to employees are subject to tax at source at the rate for extra pays. See ¶3-221. The ACC earner's levy and earners' account residual levy must also be deducted.

¶3-465 Restrictive covenants [IT07 s CE 9]

A restrictive covenant (also known as a restraint of trade agreement) can be an agreement stating that in the event of an employee's employment being terminated, the employee agrees not to carry on business in competition with his or her former employer. In return for that agreement the employee is granted a payment.

A restraint of trade agreement can take many forms, including agreements:

- not to approach the former employer's clients
- not to compete with the former employer within a certain timeframe or geographical area
- not to use confidential knowledge regarding trade practice or processes obtained while working for a former employer

Restrictive covenant payments paid to employees are income and subject to tax at the rate for extra pays. See ¶3-221. The ACC earner's levy and earners' account residual levy must also be deducted.

See further at ¶5-297.

¶3-467 Superannuation payment

An employee who terminates his or her employment will often receive a pay-out from the employer's superannuation scheme. The payment will not be taxable if the superannuation scheme is a superannuation fund as defined in s YA 1 of the Income Tax Act 2007. See ¶29-400. Effectively, a superannuation fund is a complying trust, and distributions, other than beneficiary income, derived by a person in his or her capacity as beneficiary from any complying trust will be tax free. Distributions from schemes that are not ''superannuation funds'' are taxable in the hands of the beneficiary as a taxable, distribution from a non-complying trust. See ¶29-410.

¶3-468 Damages and compensation under the Employment Relations Act or the Human Rights Act

Payments ordered by a court or authority to be made to a former employee to cover loss of wages or allowances are taxable to the recipient. PAYE must be deducted from such payments. See ¶3-050.

The exception may also apply to the sale of all the shares in a company if the company (or another company that is wholly owned — whether directly or indirectly — by the company) is carrying on a business. In this case, person B in the above criteria means the company that carries on the business. See also ¶3-465.

Anti-avoidance

A specific anti-avoidance provision under s GB 30 exists for arrangements that have an effect of avoiding the application of the restrictive covenant rule. In this case, the Commissioner may treat:

- an amount provided under the arrangement as an amount to which the restrictive covenant rule applies, and
- a person affected by the arrangement as the person who gave the undertaking.

An example of an arrangement that may be subject to this provision is an arrangement that involves a collateral arrangement to dispose of property.

Exit inducement payments

Exit inducement payments are sometimes paid by a prospective employer to an employee to induce him or her to leave his or her existing position and accept a new position. Section CE 10 deems any amount derived by a person for loss of a vocation, position or status, or for leaving a position to be income. See ¶3-460.

¶5-300 Income protection insurance [IT07 s CE 11]

Amounts derived under an income protection insurance policy where the person's employer was liable to pay or contribute to the policy's premium, will be income to the person.

Income from living allowances, foreign superannuation, compensation and government grants

¶5-302 Income — accident compensation payments [IT07 s CF 1(1)(a), (2)]

All payments of weekly compensation made by the ACC under the Accident Compensation Act 2001 (ACA) that are not recoverable under s 248 of that Act are income under s CF 1(1)(a) of the Income Tax Act 2007. Weekly compensation includes compensation for loss of earnings, or loss of potential earning capacity, and compensation for the spouse or partner, child, or other dependant of a deceased claimant. In addition, payments for attendant care (as defined in sch 1, cl 12 of the ACA) and a personal service rehabilitation payment under the ACA are also income under s CF 1(1)(a).

Compensation payments paid under the Accident Compensation Act that are specifically stated to be exempt from income tax are set out at ¶5-653.

Accident compensation payments are included in income in the year in which they are derived. Persons entitled to accident compensation may receive payment outside the income year in which their entitlement arose. The issue then becomes when such payments are derived for income tax purposes. See *Case* F157 (1984) 6 NZTC 60,350, *Case* H24 (1986) 8 NZTC 246, *Case* N9 (1991) 13 NZTC 3,075 and *Case* S9 (1995) 17 NZTC 7,084. As most employees operate on a cash basis, ACC payments are derived when they are received and the payments may not be spread over the period between the earlier year of entitlement and the year of payment.

¶5-303 Income — ACC personal service rehabilitation payments [IT07 ss CE 12, CF 1(1)(a), (2), LB 7, LB 8]

A provider who receives personal service rehabilitation payments from an ACC claimant will include those payments as income as well as the amount of any tax credit allowed in respect of those payments. The provider is given a tax credit under s LB 7 for the amount of tax deducted by ACC from the payment. This ensures that the provider's annual gross income figure is accurate for the tax year.

If an ACC claimant is paid a personal service rehabilitation payment by ACC but does not use all that payment to acquire personal care, then that payment is treated as income to the claimant for tax purposes. The claimant can then seek a tax credit for the amount of any tax withheld in respect of the balance of the personal service rehabilitation payment retained by the claimant under s LB 8.

See further ¶3-180 and ¶10-112.

¶5-305 Income — education grants [IT07 ss CF 1(1)(b), (2), CW 36]

An education grant is income to the recipient. An education grant is a basic grant or an independent circumstances grant under regulations made under s 303 of the Education Act 1989. However, any scholarship or bursary (other than those mentioned above) in respect of the recipient's attendance at an educational institution is exempt income. See also s CW 36 and ¶5-633.

¶5-307 Income — New Zealand superannuation and income-tested benefits [IT07 ss CF 1(1)(c), (e), (h), YA 1]

All payments of New Zealand superannuation, income-tested benefits, veterans' pensions and weekly compensation under the Veterans' Support Act 2014 are income.

With effect from 17 July 2013, New Zealand superannuation means New Zealand superannuation payable under Pt 1 of the New Zealand Superannuation and Retirement Income Act 2001.

New Zealand superannuation does not include:

- portable New Zealand superannuation (ie New Zealand superannuation paid or payable overseas under any of s 26(2)(a) or (b) or 31 of the New Zealand Superannuation and Retirement Income Act 2001 or s 19 of the Social Welfare (Reciprocity Agreements, and New Zealand Artificial Limb Service) Act 1990), or
- certain funeral grants, the accommodation supplement, a special benefit or a disability allowance paid or payable under any of ss 61DB, 61DC, 61DD, 61DE, 61EA, 61G and 69C of the Social Security Act 1964.

Generally, an income-tested benefit is any of the following:

- sole parent support
- emergency benefit
- youth payment
- supported living payment
- jobseeker support, and
- young parent payment.

A veteran's pension is a veteran's pension, other than a portable veteran's pension, paid or payable under Pt 6 of the Veterans' Support Act 2014.

A payment of weekly compensation under the Veterans' Support Act 2014 is made under subpart 5 of Pt 4 of that Act.

¶5-309 Income — living alone payments

Effective 2 September 2013, with application for the 2011/12 and later tax years, s CF 1(1)(d), which previously brought living alone payments within the income of the recipient, has been repealed. As part of the Government's social assistance changes, the living alone payment supplementary benefit has been replaced by changed rates of New Zealand superannuation and veteran's pension to ensure that single superannuitants and veteran's pensioners who are living alone do not have to make a separate application to receive their full entitlement. As a

- *Determination* S16: "Financial arrangement income or expenditure from certain retirement village arrangement"
- *Determination* S17: "Utilisation of a profit emerging basis for purchased debt ledgers by a certain New Zealand Company Limited"
- *Determination* S18: "Issue of perpetual non-cumulative shares by NZ Co, and related transactions"
- *Determination* S19: "Mandatory conversion convertible notes with consumer price index adjustments to face value"
- *Determination* S20: "Convertible redeemable notes and preference shares"
- *Determination* S21: "Spreading of acquisition cost of agreements for the sale and purchase of services"
- *Determination* S22: "Application of the financial arrangements rules to a public-private partnership"
- *Determination* S23: "Transfer of acquired bad debts by a certain New Zealand company to another New Zealand company in the same consolidated group and the utilisation of a profit emerging basis by the transferee company"
- *Determination* S24: "Application of the financial arrangements rules to the sale of shares in Meridian by the Crown"
- *Determination* S25: "Valuation of shares issued by Bank and HoldCo following a Non-Viability Trigger Event"
- *Determination* S26: "Valuation of shares issued by Bank following a Trigger Event"
- *Determination* S27A: "Convertible notes in respect of a limited partnership interest"
- *Determination* S28A: "Application of the financial arrangements rules to the D&C Phase in a public-private partnership"
- *Determination* S29A: "Application of the financial arrangement rules to a public-private partnership"
- *Determination* S30: "Spreading method to be used by a company and growers for a share incentive scheme and valuation of shares issued under the scheme"
- *Determination* S31: "Application of financial arrangements rules to investors in the Lifetime Income Fund"
- *Determination* S32: "Spreading method to be used by bank in respect of the notes and the value of shares issued by bank on conversion"
- *Determination* S33: "Application of the financial arrangements rules to the long term incentive plan established for senior executives of New Zealand Company Limited"
- *Determination* S34: "Spreading method to be used by bank in respect of the notes and valuation of shares issued by bank and NZHoldCo on conversion"
- *Determination* S35: "Valuation of shares issued by Bank following a conversion event"
- *Determination* S36: "Application of the financial arrangements rules to a public-private partnership agreement"
- *Determination* S37: "Application of the financial arrangements rules to the D&C Phase of a public-private partnership agreement"
- *Determination* S38: "Application of financial arrangements rules to loans by NZ Dairy Farming Trusts to New Zealand resident farmers"
- *Determination* S39: "Valuation of shares issued by bank following a non-viability trigger event"

- *Determination* S40: "Spreading method to be used by Infrastructure Provider in respect of the Provision of Services Agreement and valuation of shares issued under that Agreement"
- *Determination* S41: "Application of the financial arrangements rules to a public–private partnership agreement"
- *Determination* S42: "Application of the financial arrangements rules to the D&C Phase of a public–private partnership agreement".
- *Determination* S43: "Valuation of shares issued by Bank and NZHoldCo following a non-viability trigger event".

¶6-610 Application for a determination [TAA ss 90AB, 90AC(3), 90AD(1)]

A taxpayer may seek a determination from the Commissioner under the Income Tax (Determinations) Regulations 1987. The fees for determinations are as follows:

- application fee (non-refundable): $322.00 (GST inclusive), and
- processing fee (per hour or part thereof, exclusive of the first two hours): $161.00 (GST inclusive).

Applications should be made to:
Team Manager
Technical Services
Office of the Chief Tax Counsel
Inland Revenue National Office
P O Box 2198
Wellington

The Commissioner does have the power to waive the fees, in full or in part, in exceptional cases. Once made, the following determinations are binding on the person or class of person affected by it:

- how the yield to maturity method applies to a financial arrangement
- the method for calculating financial arrangement income or expenditure under the determination or alternative method
- the method for determining the portion of certain items treated as solely attributable to an excepted financial arrangement that is part of a financial arrangement
- the method of determining the future value or the discounted value when ascertaining the consideration amount under s EW 32(5) or (6), and
- the method to be applied when calculating the consideration amount in a base price adjustment when a financial arrangement is disposed of within a consolidated group.

Determinations are required to be published in a publication chosen by the Commissioner within 30 days after they are made, although the Commissioner must only publish the anonymous version of the determination where an applicant has given an anonymity notification.

¶6-620 Challenge to a determination

A person affected by a determination may challenge the determination in accordance with the disputes resolution procedures. A determination of this nature is treated as a disputable decision similar to an ordinary assessment or amended assessment. See ¶4-215–¶4-220.

Once made and applied, a determination forms the basis of an assessment of the person's financial arrangement income and expenditure. Limited exceptions exist for a person detrimentally affected by subsequent legislation, or if the application for a determination contained a material misrepresentation or omission.

Where the new rules apply, the entertainment expenditure rules do not apply and there is no fringe benefit tax liability. However, the deemed dividend rules may still apply. The mixed-use asset rules also override the interest deduction provisions — ss DB 5, DB 7 and DB 8.

Private use

Importantly, where a person who owns, leases, licences or otherwise has the asset uses the asset, even for market value consideration, this is caught within the ambit of the rules. This is because the legislation defines ''private use'' as use of the asset by such a person, regardless of whether an amount of income is derived in relation to its use. However, any amount that is derived is treated as exempt income. The same applies to associated persons of such a person. Note that under the mixed-use asset rules, as enacted, a person and a company were associated persons if the person had a voting interest in the company of 5% or more, or the person's share in the company gave them a right to use the asset. The 5% voting interest test of association was supposed to have been removed from the legislation before it was enacted. However, this was not done and so it was removed retrospectively by legislative amendment. Thus, a company and a person are only associated under the rules if the person's share in the company gives them a right to use the asset.

''Private use'' also includes provision of the asset to other parties for less than 80% of market value, with market value specifically defined using the concepts of open market, ordinary terms and arm's length. It is not intended to capture situations when an asset is rented by an unrelated person at a reduced price for reasons such as the asset being rented in an off-peak period, for a longer period than usual or to establish profile or market share. Exclusions include the use of assets solely in the ordinary course of the business, the required use of an asset to repair damage suffered by it, and the necessary use of an asset to relocate it for the income-earning purpose.

Example 1:

Mary owns a launch. During the course of an income year, she takes her family out on the launch, she lets her brother use the launch (paying the market rate of $200 per day) and she lets her friend use the launch (paying fuel costs only at the rate of $50 per day). All these uses are instances of private use. When Mary rents out the launch to non-associates at market rates, takes the launch to another port for rental to non-associates at $250 per day and then back again to the home port, or takes the launch to a boatyard for repair after damage was caused by a non-associate during a rental period, none of these instances is private use.

To align the treatment of income and expenditure related to private use, any income derived from private use is treated as non-assessable.

▶ ***Note:*** The Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Bill, introduced on 26 February 2015, proposes to extend the current exclusion for assets used solely in the ordinary course of a taxpayer's business to cover all situations when the asset is being used to derive assessable income of the natural person using the assets — including fees earned as a contractor and employment income. An additional amendment clarifies that use of an asset by a natural person associated with the non-natural person (eg company or trust) owner of the asset is considered to be private use. The proposed amendments will apply retrospectively from the commencement of the new rules, ie from the 2013/14 income year for land and from the 2014/15 income year for boats and aircraft.

Apportionment of expenditure

Expenditure that relates solely to business use of the asset (such as advertising expenditure) is not subject to apportionment and is fully deductible. In addition, expenditure that relates solely to private use or solely to capital use is non-deductible. Thus, the apportionment rules apply to general expenditure that is not specifically attributable to either business, private or capital use. Note that the rules provide that expenditure on repairs and maintenance will always be subject to apportionment. The only exception to this is where costs are incurred to

repair explicit damage caused when an asset is used to earn income (for example, if renters cause damage to a bach during the rental period, the costs of repairing that damage is deductible in full).

In addition, if some or all of the expenditure on an asset is apportioned for tax purposes on the basis of space, floor area or a similar basis, that method of apportionment overrides the rules in subpart DG to the extent of the amount of the deduction. Thus, for example, the mixed-asset rules will not apply to a home office where the expense claim is based on floor area.

Where the criteria listed above are satisfied, s DG 9(2) provides a formula that apportions the expenditure between ''income-earning days'' and the total of income-earning days plus counted days (being the total number of days when the asset is in use, excluding income-earning days). The proportion of expenditure that is deductible is calculated by multiplying the expenditure by the following formula:

income-earning days ÷ (income-earning days + counted days)

Example 2:

Jim rents out his aeroplane at market value for 100 hours in an income year and uses it for his personal enjoyment for 50 hours. Jim incurs expenditure of $10,000 for general repairs and maintenance of the plane. He may deduct two-thirds of the expenditure. The formula is $10,000 × (100/(100 + 50)) = $6,666.67.

Treatment of interest when asset held in corporate structure

Special rules determine the interest expenditure to which the apportionment calculation applies when mixed-use assets are held by close companies. These rules counteract any possible tax advantage to holding mixed-use assets in a corporate structure because of the automatic deduction for interest for companies and the ability of shareholders to deduct interest they incur on debt to buy shares. If the value of the company's debt is equal to or less than the value of the mixed-use asset, all of the company's interest is subject to apportionment. If the debt value is more than the asset value, then apportionment only applies to a part of the company's interest expenditure. That part is calculated by multiplying the interest expenditure by:

asset value ÷ debt value

asset value means the adjusted tax value of the property, except in the case of land. For land and land improvements, asset value is the following amount, as applicable:

- the later of its most recent local body capital value or annual value or its acquisition cost or, if the transaction involves an associated person, its market value
- if it is a leasehold estate, the market value of the leasehold estate, based on a registered valuation less than three years old, and
- if different activities are carried out on a single piece of land, the value determined under either of the above bullet points adjusted:
  - by multiplying the value by the percentage of the land area used for the mixed-use activity, or
  - by a registered valuation of the portion of the land used that is less than three years old, and

debt value means the average outstanding amount giving rise to the interest payable by the company, based on the amounts outstanding at the start and the end of the income year.

Example 1 (pre-31 March 2015):

Mr and Mrs Jones are separated. Mrs Jones has custody of the two children from the marriage. Mr Jones is now living by himself. Mr Jones only derives income from salary and interest, and his taxable income in the 2013/14 tax year was $45,000. Mr Jones' child support liability for the year commencing on 1 April 2014 is as follows:

Income	$45,000
less living allowance	$15,058
Balance	$29,942
Multiplied by the two-child percentage	24%
Child support liability	$7,186.08 pa ($138.19 per week)

Example 2 (pre-31 March 2015):

Mr and Mrs Smith are separated. Mr Smith has custody of the three children from the marriage. Mrs Smith is now living by herself. Mrs Smith's taxable income for the 2013/14 tax year from her business amounted to $50,900. Mrs Smith's child support liability for the year commencing on 1 April 2014 will be:

Income (after inflation adjustment of 1.6%)	$51,714
less living allowance	$15,058
Balance	$36,656.40
Multiplied by the three-child percentage	27%
Child support liability	$9,897.23 pa ($190.33 per week)

Shared custody

Prior to 31 March 2015, custody was deemed to be shared between two parents when each parent shared the ongoing daily care of a child or children "substantially equally" with the other parent. A parent was deemed to share ongoing daily care substantially equally if he or she cared for a child for at least 40% of the nights (ie 146 nights) in the year. However, a parent who cared for a child for less than 40% may still have qualified for shared custody status if he or she had responsibility for other aspects of the child's care, such as making decisions about the child's daily activities, taking the child to and from school, supervising the child's leisure activities, making decisions about the child's education or health care, making financial arrangements for the child's material support and paying for the child's expenses. See *Johns v C of IR* (1998) 18 NZTC 14,019; *C v C of IR* [2010] NZFLR 646.

In cases of shared custody, both parents were treated as custodians and liable parents. The percentage rate referred to above was effectively reduced to take into account the shared custody. Each child for whom custody was shared was counted as 0.5 of a child. The percentage rates for shared custody were:

Number of children	Percentage rate (%)
0.5	12
1	18
1.5	21
2	24
2.5	25.5
3	27
3.5	28.5
4 or more	30

Example 3 (pre-31 March 2015):

Mr and Mrs Brown are divorced. There are three children from the marriage. Each parent has full-time custody of one child with shared custody of the third. Mrs Brown's taxable income for the previous year was $35,000. Mr Brown's taxable income for the same period was $50,000. Both Mr and Mrs Brown are liable to pay the other parent child support for 1.5 children, ie one full-time care and one shared custody.

Liability	*Mrs Brown*	*Mr Brown*
	$	$
Income	35,000.00	50,000.00
less living allowance (for 2 children)	31,222	31,222
Balance	3,778	18,778
Multiplied by % for 1.5 children	× 21%	× 21%
Child support liability	793.38	3,943.38

Inland Revenue will offset the two liabilities. Because Mrs Brown's liability is less than Mr Brown's, Mrs Brown is not required to make any payment. Mr Brown only has to pay the difference between the two liabilities, ie $3,943.38 minus $793.38, which is $3,150.

¶12-020 Departure from the child support formula assessment [CHS Pts 6A, 6B, 7, ss 104–106]

In certain circumstances, the Commissioner may make a determination allowing a departure from the formula assessment for calculating child support (see ¶12-015). The determination process can be commenced at the request of any liable parent or receiving carer of a qualifying child, or by the Commissioner.

The procedure is known as an "administrative review" and involves a hearing with an independent review officer. The procedures are similar to the process for a Family Court departure order.

Applications for child support review by liable parents or receiving carers

Liable parents or receiving carers of qualifying children may make applications for an administrative review of child support where they consider special circumstances exist to depart from the standard formula calculation. All applications for administrative review must be in writing, stating the grounds on which the application is made. All other parties to the child support assessment are advised of the application and have the right to reply, confirm or contest any details given by the applicant and the right to attend the hearing.

The Commissioner can make a determination varying the amount of child support payable when:

- at least one of the special circumstances set out in s 105(2) of the Child Support Act 1991 is satisfied
- it is "just and equitable" for the child and all parties to the application that a determination be made: see *L v W* (1994) 16 NZTC 11,279 (CA), and
- it is "otherwise proper" that a determination be made: see *C of IR v Cutbush* (1994) 16 NZTC 11,307.

Section 105(2) is an exhaustive list of the special circumstances that are able to be considered as grounds for a determination by the Commissioner or a Family Court departure order. The special circumstances all focus on economic considerations. Some examples of the special circumstances covered by s 105(2) are as follows:

- Where either parent's ability to provide financial support is significantly affected by that parent's duty to maintain another special needs child.
- Where the liable parent's costs to enable access to the child are more than 5% of the year's adjusted taxable income.

Dividend from foreign company

Dividends derived from a foreign company by a New Zealand company are also exempt income: s CW 9. There are a number of exclusions to this general rule, including:

- dividends from a direct income interest in certain foreign investment funds (FIFs) (comprising shares in ASX-listed Australian companies, Australian unit trusts with adequate turnover or distributions, certain venture capital investments into New Zealand companies that have since migrated, and certain grey list companies)
- dividends from fixed-rate foreign equity
- dividends from deductible foreign equity
- dividends derived by a portfolio investment entity
- in certain circumstances, dividends derived by a person from a direct income interest of 10% or more in an Australian resident FIF.

A foreign company is defined in s YA 1 as:

- a company that is not resident in New Zealand, or
- a company that is treated under a double tax agreement as not being resident in New Zealand.

LIQUIDATION

¶16-850 Liquidation of a company [C93 sch 7; IT07 s RA 23; TAA ss 44, 167–170]

The liquidation of a company raises a number of aspects.

Authorisation

The person appointed as liquidator must consent to act before the liquidation is commenced. See *C of IR v Edmonton Group Ltd* (2004) 21 NZTC 18,679.

The liquidator as the person responsible for operation of a company in liquidation would need to make all necessary returns of income incorporating the company's trading activities. The Commissioner has the power at any time to demand that a return of income be filed in relation to a company in liquidation. The demand may be for a specified period or in respect of a particular transaction. See s 44 of the Tax Administration Act 1994 (TAA).

In some instances, possible application of the capital limitation to prevent the deduction of expenses may be an issue. This is because of the capital complexion, in part at least, of the liquidation process. The process may involve realisation of the company's capital structure. Nonetheless, expenses fairly referable to continued operation of the company's trading operations can be expected to be allowed as a deduction.

Distributions on liquidation are discussed at ¶16-720.

Tax losses

The fact of liquidation may be regarded as having no impact on the ability of the company to carry forward a loss balance from a prior income year. Liquidation does not impact on the voting interests carried by shares of the company. Liquidation merely affects management of the company upon the control of operations passing from the company's directors to the liquidator.

The position was reviewed in Australia in *FC of T v Linter Textiles Australia Ltd (in liq)* 2005 ATC 4255. This case related to a situation involving both a loss company and its shareholder being placed in liquidation. The Court concluded that the loss company was not able to continue to carry-forward its losses because of the effect of liquidation of its shareholder company. (The law in Australia was later changed to reverse the *Linter* decision.)

One of the tests for the loss company being able to carry forward its losses was that the voting power in that company continued to be controlled, or capable of being controlled, by the same natural persons (disregarding any interposed companies). Upon liquidation of the shareholder company, the natural persons who formerly controlled the shareholder company ceased to do so. Those natural persons had ceased to be capable, for example, of carrying an ordinary resolution at a general meeting of shareholders of the loss company. The ability to exercise the rights attaching to the shares passed to the liquidator of the parent company as the person who assumed control of the assets of that company. Control of the shares of the shareholder company, also in liquidation, passed to the liquidator of that company.

In reaching this conclusion, the courts confirmed that the fact of liquidation did not impact on the voting rights carried by shares in the loss company that were held by the shareholder company. Those shares did not, for example, become subject to a trust in favour of the creditors and shareholders of the loss company. The shareholder of the loss company continued to be the beneficial owner of the shares in that company.

This supports the view that the commencement of the liquidation of a loss company would not prevent the continued carry-forward of its losses. The shareholder rights carried by those shares are not changed by the liquidation of the company itself. The liquidation merely operates to change who may control the affairs of the company.

The liquidation of a company has the effect of remitting any debts owed by the company. If those debts have formed part of a tax loss that has been used against the income of another company in the same group of companies, the Commissioner is entitled to reassess the profit company to disallow the grouping of tax losses. The remitted debt ceases to be a deduction able to be taken into account to arrive at the tax loss. See *Hotdip Galvanisers (Christchurch) Ltd v C of IR* (1999) 19 NZTC 15,337 (CA).

Preferences

When a company is liquidated, the Commissioner ranks as an unsecured creditor for tax derived on income prior to the date of liquidation. Consequently, a liquidator would be unwise to pay the demands for tax immediately, merely to avoid late payment penalties, since doing so would amount to undue preference being given to one particular creditor over another.

Combined tax and earner-related payments deductions (excluding any late payment or shortfall penalties) made under the PAYE rules are held in trust for the Crown. This is also the case for deductions of employer superannuation contribution tax and non-resident withholding tax.

Should the company become insolvent, any such tax deductions so held remain separate property and do not form part of the estate in liquidation (or upon the appointment of a receiver). They are deemed to become a debt due and payable to the Commissioner on the 20th of the month following the month in which the relevant payment to the employee is made.

Jennings Roadfreight decision

The High Court in *Jennings Roadfreight Ltd (in liq) v C of IR* (2012) 25 NZTC ¶20-135 concluded that if an amount of PAYE has not been paid to the Commissioner when liquidation of a company commences, the deemed trust imposed under s 167 of the TAA in favour of Inland Revenue ceases and the Commissioner then becomes a creditor in the liquidation. However, on appeal, the Court of Appeal overturned the High Court decision and

¶23-070 Avoidance [IT07 s GB 50]

A specific anti-avoidance rule applies for partnerships where a partner of a partnership enters into a transaction for consideration that is greater than or less than market value and that has a purpose or effect of defeating the intent and application of the partnership provisions. Where this section applies, the transaction will be deemed to have taken place at market value.

TAXATION OF LIMITED PARTNERSHIPS

¶23-080 Loss limitation rule [IT07 ss HG 11, HG 12]

A loss limitation provision applies to limited partners in a limited partnership. It is intended to ensure that tax losses claimed by limited partners reflect the level of the limited partner's economic loss. General partners, on the other hand, are entitled to a full deduction for their share of partnership tax losses.

Under the loss limitation rule, a limited partner's "limited partnership deduction" is restricted to the tax book value of his or her investment in the limited partnership (referred to in the legislation as the "partner's basis").

"Limited partnership deduction" is defined as the deduction that a limited partner would otherwise have been allowed for partnership expenditure under the general flow-through provision in s HG 2 or the loss carry-forward rule in s HG 12.

A partner's basis is calculated using the following formula under s HG 11(3):

investments − distributions + income − deductions − disallowed amount

where, generally:

investments is the market value of capital contributions made by the partner to the limited partnership, including a loan by a limited partner to a limited partnership, along with any guarantees provided by the partner (or an associate of the partner) to the partnership

distributions is the market value of distributions to the partner from the partnership

income is the partner's share of total income (including exempt and excluded income, and capital gains and certain FIF income) received from the partnership in the current and preceding tax years

deductions is the partner's share of partnership deductions and capital losses in previous tax years, and

disallowed amount is the amount of investments made by the partner within 60 days of the last day of the income year, if those investments are or will be distributed or reduced within 60 days after the last day of the income year.

The "disallowed amount" is essentially an anti-avoidance mechanism to exclude any investments made by the partner in the last 60 days of an income year that are subsequently withdrawn within the first 60 days of the following income year. This component of the calculation prevents partners artificially inflating their basis at the end of the income year to increase their allowable partnership tax loss deduction.

A limited partner will be entitled to a tax loss deduction for their share of partnership losses up to the value of their "basis". Any losses exceeding the amount of the basis may be carried forward to future income years. A deduction may be allowed in future income years subject to the general loss limitation rule.

Example:

The following example illustrates the operation of the loss limitation provision.

Assume the Tom & Jerry Limited Partnership derives business income in year one of $200,000 and incurs allowable deductions of $350,000 (resulting in a tax loss of $150,000 for the year). In year two, the partnership derives business income of $300,000 and incurs allowable deductions of $250,000 (resulting in taxable income of $50,000).

Tom invested $60,000 of initial capital for a 50% share in the partnership.
Tom's basis in year one (assuming that no partnership distributions are made during the year) is calculated as follows:

Basis	=	Investments	−	Distributions	+	Income	−	Deductions	−	Disallowed amount
$160,000	=	$60,000	−	$0	+	$100,000	−	$0	−	$0

As Tom's basis is $160,000, he will only be entitled to claim limited partnership deductions of $160,000. Therefore in year one Tom will return partnership income of $100,000 and partnership deductions of $160,000 (giving a net partnership loss for the year of $60,000). The remaining $15,000 of Tom's $175,000 share of partnership losses will be carried forward to year two.
In year two, Tom's basis will be calculated as follows:

Basis	=	Investments	−	Distributions	+	Income	−	Deductions	−	Disallowed amount
$150,000	=	$60,000	−	$0	+	($100,000 + $150,000)	−	$160,000	−	$0

Tom's limited partnership deduction in year two is $140,000 (being his 50% share of year two deductions of $125,000 plus deductions carried forward from year one of $15,000). As Tom's basis is $150,000 he will be entitled to claim the full partnership deduction of $140,000. Therefore, in year two Tom will return partnership income of $150,000 and partnership deductions of $140,000, giving Tom net partnership income of $10,000.

Limited partner subsequently becoming a general partner

It is possible for a limited partner to become a general partner. To prevent the loss limitation rule being circumvented, the loss limitation rule also applies to general partners who:

- were limited partners of the limited partnership within 60 days of the last day of the income year, and
- are (or will be) limited partners of the limited partnership within 60 days after the last day of the income year.

"Complying trust" defined

A "complying trust" is defined in relation to a tax year in which a distribution is made. A trust will be a complying trust in relation to that year if, in all tax years since the trust was first settled:

- no trustee income includes:
  - non-resident passive income, or
  - non-resident's foreign-sourced income, or
  - exempt foreign-sourced amounts, and
- all of the trustee's New Zealand income tax obligations have been satisfied.

Each of the requirements of the definition of "complying trust" is discussed in more detail below.

No trustee income is non-resident passive income

A trust will not be a complying trust if, in any tax year since the trust was first settled, any trustee income has been taxed only as non-resident passive income (ie income subject to non-resident withholding tax as a final tax, see ¶26-460). This means that trusts with non-resident trustees that derive non-resident passive income will not be complying trusts (unless all of the non-resident passive income is distributed as beneficiary income). Trusts with resident trustees or trusts with non-resident trustees who do not derive non-resident passive income are not affected.

Example 1:

A New Zealand resident establishes a trust with non-resident trustees. The trustees derive dividends from New Zealand as well as rental income. All income of the trust is accumulated as trustee income. As some of the trustee income (dividends) has been liable to New Zealand income tax only as non-resident passive income, the trust is not a complying trust — it is a non-complying trust.

No trustee income is non-resident's foreign-sourced income

A trust will not be a complying trust if, in any tax year since the trust was first settled, the trustee has derived any non-resident's foreign-sourced income. Trustee income is non-resident's foreign-sourced income if:

- the income does not have a New Zealand source
- the trustee is non-resident when the income is derived, and
- s HC 25(2) does not apply.

Section HC 25(2) will apply if:

- a settlor (who is not a transitional resident) is a New Zealand resident, or
- the trustee is resident in New Zealand and the settlor died, resident in New Zealand, or
- the trust is a superannuation fund.

Section BD 1(5) excludes non-resident's foreign-sourced income from the definition of assessable income.

No trustee income includes exempt foreign-sourced income

A trust will not be a complying trust in a tax year in which it makes a distribution if, in any tax year since the trust was first settled, a New Zealand resident trustee of a trust that does not have a settlor who is a New Zealand resident (who is not a transitional resident) has derived any exempt foreign-sourced amount.

In broad terms, a "foreign-sourced amount" is an amount that is not derived from New Zealand. A foreign-sourced amount will be exempt income to a trustee to the extent that s HC 26 applies (see s CW 54).

For more on when foreign-sourced amounts are excluded from a trustee's income, see ¶25-035. For more on transitional residents, see ¶5-700.

Example 2:

On 27 April 2013 a trust is settled by two non-resident settlors upon New Zealand resident trustees. On 22 April 2014 the settlers become resident in New Zealand.

The only income of the trust in the 2013/14 year was rent derived from New Zealand. In the 2014/15 year, the trustees derived rent and interest, both from New Zealand and overseas. All of the trustees' New Zealand tax obligations have been met.

The trustees make a distribution to beneficiaries in the 2014/15 tax year. In relation to that distribution, the trust is a complying trust because:

- the trustees are New Zealand residents and have never derived non-resident passive income
- the settlors of the trust were resident in New Zealand in the tax year in which foreign-sourced amounts were derived by the trustees, so the foreign-sourced amounts are not exempt income of the trustees under s CW 54, and
- all of the trustees' New Zealand tax obligations have been met.

All of trustee's New Zealand income tax obligations must be satisfied

To be a complying trust in relation to a distribution, in all tax years since the trust was first settled, all of the trustee's New Zealand tax obligations must have been satisfied.

Satisfaction of trustee's income tax obligations

For the purposes of the definition of "complying trust", a trust that is a non-complying trust only because income tax has been underpaid or some other tax obligation has not been met can retrospectively become a complying trust if the tax obligation is satisfied. Taxable distributions made during the period when there was an underpayment or some other tax obligation not met are effectively unwound.

All income paid out as beneficiary income

In some circumstances, a trustee may derive income but pay it all out as beneficiary income, and therefore not be liable for income tax in respect of that income. This would not, in the Commissioner's view, take a trust outside the definition of a complying trust. See *Tax Information Bulletin* Vol 6, No 9, February 1995 at 2.

Exemption for foreign-sourced amounts

There is a limited exemption that relieves a non-resident trustee from the obligation to pay tax on income derived from outside New Zealand and that would otherwise be included in the trustee's income. See s HC 25 and ¶25-035. However, the exemption is ignored when determining whether the trust is a complying trust; the trustee income remains liable to income tax and that liability must be satisfied. As neither the settlor nor the trustee will be liable for tax on the income, the trust will only be a complying trust in relation to distributions if an election to pay tax on trustee income is made in accordance with s HC 33 (see ¶25-085) and the tax is paid.

Example 3:

In 1985 a New Zealand resident settlor settled a trust upon non-resident trustees. No settlements have since been made on the trust. The non-resident trustees derive income from outside New Zealand. No election has been made to pay tax on trustee income. As no settlement has been made on the trust after 17 December 1987 and no election has been made by the trustees to pay tax on trustee income, the trustees are exempted

in the sale and purchase agreement, that price is income to the vendor and the purchaser can claim an equivalent deduction. If no separate price is assigned in the agreement to growing crops, the total crop proceeds will be income to the purchaser when the crop is harvested and sold. See *Tax Information Bulletin* Vol 4, No 4, November 1992 at 8, and *Case* T1 (1997) 18 NZTC 8,001.

Financial arrangements rules

The sale and purchase of a farm property can have financial arrangements rules implications where there is a deferred settlement involved. This does not include short-term agreements for the sale and purchase of property because they are classified as excepted financial arrangements. See ¶6-065. If no financing element is intended in relation to a deferred property settlement, the sale and purchase agreement should contain a clause specifying that the price stated in the agreement is the lowest price that the parties would have agreed on at the time at which the agreement was entered into, on the basis of payment in full at the time at which the first right in the property is to be transferred. Such a clause protects the vendor's position. Where a clause like this is omitted, the purchaser could get a notional interest deduction for part of the purchase price of what would normally be considered a capital payment. See ¶6-400.

GST considerations

Taxable supplies wholly or partly consisting of land are zero-rated (subject to GST at the rate of 0%) if:

- the recipient is GST-registered and intends to use the land for making taxable supplies, and
- the land is not intended to be used as a principal place of residence by the recipient or a relative of the recipient.

See ¶32-505.

When buying or selling a farming property, it is still generally preferable to use the wording "plus GST (if any)" in the sale and purchase agreement. This fixes the consideration received and payable by both parties net of GST (assuming that the purchaser is GST-registered and can recover any GST impost). However, a GST-registered purchaser who anticipates claiming a secondhand goods input tax credit (see ¶32-056) in respect of a purchase might insist on "GST-inclusive" wording to protect their position, should it transpire that the transaction is in fact subject to GST.

Any purchaser buying property that includes a dwelling needs to be aware that the supply will be apportioned between the supply of the land and the supply of the dwelling and that the purchaser may have to pay GST on that portion of the price relating to the dwelling if the vendor has previously claimed an input credit (or adjustment) on it where the price in the sale and purchase agreement is "plus GST" or "plus GST (if any)". See ¶27-061 and ¶32-555.

Any person selling a farming operation as a going concern (rather than as a zero-rated supply of land) must specify that fact in writing (preferably within the sale and purchase agreement) and should consider using "plus GST (if any)" pricing. The requirements for the transfer of a going concern are set out more particularly at ¶32-035.

¶27-013 Sale of timber [IT07 ss CB 24, DP 11]

The general principle is that a farmer who harvests a woodlot situated on the farmer's farm returns as income the amounts realised from the timber sales, with a corresponding deduction being available for the cost of the timber. See ¶28-014 and ¶28-024.

¶27-015 Deductions for farmers [IT07 ss DA 1, DB 62, DO 1–DO 4, DO 11, EA 3, EE 48(3), EJ 3, sch 20]

Farmers can claim the normal deductions allowed in carrying on a business for the purpose of deriving income. There are additional deductions a full-time farmer can claim. These are set out below.

Aircraft expenses

A deduction is permitted for running costs and depreciation in respect of the use of an aircraft for farming purposes. Any apportionment between farming and private use should be based on the total number of flying hours devoted to farming purposes in proportion to total flying hours for the year as recorded in the aircraft's logbook. The costs of obtaining a pilot's licence are not considered by the Commissioner to be deductible, this being an item of capital or private expenditure. See *Tax Information Bulletin* Vol 6, No 14, June 1995 at 24.

▶ ***Note:*** If an aircraft is used for both business and private purposes and the aircraft cost $50,000 or more, or has a market value on date of acquisition of $50,000 or more if it was not acquired at market value, from the 2014/15 income year expenditure incurred on that aircraft may be subject to apportionment under the new mixed-use asset rules in subpart DG. See ¶10-035.

Compensation for sheep-worrying damage

The Commissioner permits a farmer a deduction for any compensation paid for any sheep-worrying damage the farmer's working dogs might have done (assuming the particular facts showed this was an ordinary incident of business). The compensation is returned as income by the sheep owner recipient.

Dairy farming expenditure

Certain dairy farming expenditure may be deductible under the general permission, or under s DO 1 or DO 4 (see ¶27-165 and ¶27-175).

An interpretation statement, IS0025, "Dairy farming — deductibility of certain expenditure", sets out the Commissioner's view on the deductibility of a number of expenditure items relating to operating a dairy farm. See *Tax Information Bulletin* Vol 12, No 2, February 2000 at 10. The Commissioner's conclusions can be summarised as follows:

- subject to some exceptions, the cost of replacing a single component of milking plant (eg a pump or the pulsator units) is generally deductible
- some components of a milking plant are non-deductible capital items, because they are unlikely to be replaced other than as part of an upgrade (eg stainless steel pipe work and milk filters)
- where a number of milking plant components are upgraded at the same time, the cost is usually on capital account and not deductible
- the cost of replacing an inlet race is a capital expense; see QB 12/01: "Income tax — deductibility of expenditure on replacing and extending an inlet race to a dairy shed", published in *Tax Information Bulletin* Vol 24, No 2, March 2012 at 19
- the cost of replacing either the rotary platform system or the drive mechanism of the rotary platform is a non-deductible capital expense
- the cost of replacing the electric motor in a rotary platform system is deductible
- the piping used in a dairy shed complex is not a fence for the purposes of s DO 1 or DO 4

¶28-090 Land of a mineral miner [IT07 ss DU 3, YA 1]

Consideration derived from the disposal of land is treated as income of a mineral miner where the land is, or forms or is intended to form part of, a mining permit area or land adjacent to it: see ¶28-060.

A mineral miner is allowed a deduction for land or interests in land acquired.

However, no deduction is available for expenditure on land that does not constitute a mining permit area or land adjacent to it, or does not form, or is not intended to form, part of a mining permit area or land adjacent to it. A deduction is also denied if the expenditure is mining prospecting expenditure. In addition, any expenditure for which the miner has a deduction before disposing of the land or interest in land is also excluded.

The deduction is allowed in the income year the miner disposes of the land or interest in land. This means that the timing of this deduction will match any income derived under the new rules, and so a net income amount or deduction will be available in that year, depending on whether the land is sold for a profit or loss.

The disposal of land may be the final act of a miner's operations, so it could occur in a period when no income-earning activity takes place. As for mining rehabilitation expenditure, any loss attributable to land sales may be eligible for a tax credit under the new rules, discussed in ¶28-105.

¶28-095 Deductions for mineral mining assets [IT07 ss DU 4, DU 5, YA 1]

Expenditure on the acquisition of a mineral mining asset is either immediately deductible or spread under one of the two available methods, depending on the timing of its acquisition. If the asset is acquired before the date a mining permit for the permit area to which the asset relates is obtained, then the expenditure is immediately deductible. Once a mining permit has been obtained, expenditure incurred on acquiring a mineral mining asset is treated as mining development expenditure and is therefore spread.

Expenditure for these purposes does not include the actual application costs for a mining right or permit.

The purchaser of a mineral mining asset is eligible for a deduction for that expenditure (either immediately or over time) and the person disposing of that asset will treat the consideration received as income (as discussed above).

However, if a person, instead of acquiring the mineral mining asset outright, agrees to incur farm-in expenditure, the new rules clarify that this expenditure is to be treated as if it were the applicable class of mining expenditure. If, for example, the expenditure was classified as development expenditure, the farm-in party would be allowed a deduction for that amount under one of the spreading methods. As the existing rights holder is not getting any money from the farm-out arrangement, the expenditure of the farm-in party is excluded income to the farm-out party.

¶28-100 Other types of expenditure of a mineral miner

Other types of expenditure not covered by the new rules are covered by the appropriate general rules set out in the Act. This includes the application of the capital/revenue distinction in determining whether expenditure is immediately deductible, deductible over time or not deductible.

¶28-105 Tax credits for mineral miners [IT07 s LU 1]

A new subpart LU has been inserted to allow mineral miners a refundable credit in circumstances when the miner has a net mining tax loss for a mining permit area for the income year that is greater than the net income of the miner for the income year from all other sources (the difference being the excess amount). To calculate this, the miner's net mining

loss is treated as if their only income were income derived from the mining permit area and the miner's net income from other sources is treated as if there were no income from the mining permit area. The value of this credit is limited to the total income tax liability attributable to the relevant permit area.

For a mineral miner to obtain a tax credit, the miner must also have either:

- incurred an amount of mining rehabilitation expenditure
- disposed of land for a loss, or
- incurred mining development expenditure in relation to a mining permit area for which the mining permit has been relinquished, revoked or surrendered or has expired and the miner has no existing privilege for the permit area.

The amount of the tax credit is calculated using the following formula:

expenditure or loss × tax rate

The "expenditure or loss" is the excess amount referred to above to the extent to which it consists of the amounts listed above.

The total amount of the credit will be limited to the lesser of:

- the result of the formula, and
- the income tax paid by the miner on net mining income derived for all earlier tax years to the extent to which it relates to the permit area, calculated on a year-by-year basis and aggregated.

Special rules apply to clarify the amount of the tax credit in cases where the credit is available to non-companies, that is trustees and individuals.

The new rules also clarify that any loss giving rise to a credit does not form part of a tax loss component or net mining loss of the miner. This is to prevent a miner from claiming a credit and also using the same loss to offset any future income.

The credit generated is refundable.

¶28-110 Anti-avoidance rules for mineral miners [IT07 s GB 20]

The anti-avoidance rules in s GB 20 that apply to petroleum miners have been extended so that they also apply to mineral miners.

The section now applies when an arrangement includes the disposal of a mineral mining asset, the incurring of one or more of the classes of mineral mining expenditure, or a farm-out arrangement, and the arrangement has a purpose or effect of tax avoidance. In those circumstances, the Commissioner may adjust the taxable income of any person affected by the arrangement so as to counteract any tax advantage obtained by the person.

Several types of arrangements involving the disposal of a mining asset, the incurring of mining expenditure or the entering into a farm-out arrangement are specifically included within the section as arrangements having the effect of tax avoidance.

¶28-117 Consolidation regime and mining companies [IT07 s FM 31(2)(b)]

A mineral miner that is a company may form a consolidated group only with other companies that are mineral miners. See also ¶20-010 for a discussion of consolidation.

¶28-118 Tax losses [IT07 s IA 7(7), (8), subpart IS]

For discussion on the rules for carrying forward tax losses by a company that is a mineral miner, see ¶18-045.

suffered by people in paid employment and self employment (except motor vehicle accidents, which are funded by a tariff on the price of petrol and a component of the motor vehicle licensing fee).

Basis for levy payments

Levies are payable for a levy year, which runs from 1 April to 31 March the following calendar year. Levies payable by employees are based on earnings and are collected through the PAYE system. Levies payable by employers and self-employed persons are invoiced annually by the ACC. Invoices are generally posted from July in each year, dependant on when ACC receives earning information from Inland Revenue. The work account levy paid by employers is based on earnings paid to employees in the current levy year. Levies payable by the self-employed are based on their previous years' earnings.

Injury cover

The standard injury cover for self-employed persons is called ACC CoverPlus. Under ACC CoverPlus, all full-time self-employed people who are incapacitated and have earnings are eligible for weekly compensation, generally based on their earnings in the previous year. Self-employed persons and non-PAYE shareholder-employees may apply to purchase ACC CoverPlus Extra that allows them to choose a guaranteed level of weekly compensation. The applicable levy is adjusted to reflect the nominated level of cover.

The standard cover option for employers is ACC WorkPlace Cover. The ACC automatically calculates levies and invoices employers for this cover every year. Employers also have the option of joining the ACC Partnership Programme, which offers significant levy discounts to employers who take responsibility for their own workplace health and safety, injury management and rehabilitation of employees' workplace injuries. See ¶31-025.

Summary of levies

The table below summarises the various ACC accounts and the injury types they fund:

Account	Funded by	Covers	Entitlements
Current portion of the Work account	Employers (based on liable earnings of their employees), self-employed and private domestic workers (based on their liable earnings)	Work-related personal injuries affecting employees, the self-employed and private domestic workers	Medical and dental treatment Income replacement (lost earnings compensation) Elective surgery
Residual portion of the Work account	Employers (based on liable earnings of their employees), self-employed and private domestic workers (based on their liable earnings)	Continuing cost of work-related personal injuries sustained prior to 1 July 1999 Non-work injuries to earners sustained prior to 1 July 1992	Rehabilitation (including aides) Transport costs, home help and assistance re-entering the job market
Current portion of the Earners' account	Employees, self-employed and private domestic workers (based on their earnings)	Non-work injuries (sustained at home, sport or recreation) suffered by people in the workforce	Lump sums and death-related entitlements for surviving spouses and children

Account	Funded by	Covers	Entitlements
Residual portion of the Earners' account	Employees, self-employed and private domestic workers (based on their earnings)	Continuing cost of non-work injuries to earners that were sustained between 1 July 1992 and 30 June 1999	
Motor vehicle	Motor vehicle owners and users (via an annual motor vehicle levy and a petrol levy)	Motor vehicle injuries sustained on public roads (except injuries covered by the Work account)	
Non-earners account	Government	Personal injuries sustained by people not in the paid workforce, eg students, beneficiaries, children, pensioners	
Treatment injury	Earners (through earners' levies — see above) and Government	Personal injuries caused by medical treatment	

...ble from the ACC website (www.acc.co.nz).

ACCIDENT COMPENSATION LEVIES

¶31-015 ACC levies payable by employers and private domestic workers [AC ss 6, 9–12, 168–174, 234, 239, 244, 250]

In the 2015/16 levy year, employers will pay the work account levy, based on 2014/15 employee earnings paid by the employer. The work account levy has two components, namely, the current portion (which funds the current and future costs of work-related injury claims made in the levy year) and the residual portion (which pays for the ongoing costs of claims for work injuries that happened before 1 July 1999 and non-work injuries that happened before 1 July 1992). The work account levy regulations set separate maximum amounts of earnings for the current portion and the residual portion of the work account levy payable by an employer or a private domestic worker.

With respect to invoicing, the work account levy is based on an estimate of the salary or wages that will be paid by the employer in the year of cover or, in the case of a private domestic worker, the amount of earnings received in the levy year as a private domestic worker. The estimate is made by the Accident Compensation Corporation (ACC) using liable earnings information provided by Inland Revenue for the previous levy year. For example, the ACC invoices employers from July 2015 for the work account levies it estimates are payable for the 2015/16 cover year, based on 2014/15 earnings. Once employers have filed their tax returns for the 2015/16 tax year, adjustments to the estimated levies paid for the 2015/16 cover year are made by the ACC. If levies have been overpaid by less than $20, credits are given to the employers for the 2016/17 cover year. Overpayments of more than $20 are refunded by the ACC. Further, if an overpayment is more than $1,000, the ACC must pay interest on the refund. For the 2015/16 levy year the interest rate is 6%. If levies have been underpaid by more than $20, invoices are issued for the difference. See s 173 of the Accident Compensation Act 2001 (AC Act) and reg 51 of the Accident Compensation (Work Account Levies) Regulations 2015.

- Progress payments for building or an engineering work and for goods supplied progressively — s 9(3)(aa)

  Time of supply will be the earlier of the time a progress payment is made, is due or an invoice is issued in respect of the progress payment. This rule applies where goods are supplied progressively under an agreement that provides for periodic payments or where goods and services are so supplied directly in the construction, major reconstruction, manufacture, or extension of a building or an engineering work. Typically work will be paid for by instalments in direct connection to progress of the work.

- Public authorities — s 9(7)

  A public authority is deemed to have made a supply where an amount is brought to charge as revenue from the Crown. This supply is deemed to take place in the taxable period in which the bringing to charge applies.

- Race bets and sports betting — s 9(2)(d)

  The time of supply made by the New Zealand Racing Board or its agent to secure a bet is the time the money is "dealt with" under the relevant legislation; that is, the time that it is established for GST purposes that a supply has been made.

- Rates demands issued by local authorities — s 9(8)

  Time of supply for rates demands issued by local authorities will be the earlier of:

  - the date the instalment notice issued if the notice requires payment of an instalment by a particular date
  - the date on which the notice requires payment, or
  - the date on which payment is received.

- Supplies where the price is not determined — s 9(6)

  Occasionally, goods or part of them may be removed before the price is set. Time of supply is deemed to take place when and to the extent that any payment under the agreement is due or is received or any invoice relating to the supply is issued by the supplier or recipient (whichever is earlier).

  Example 3:

  A farmer sells produce to an exporter for a down payment on 11 October 2014, plus an end-of-season catch-up payment to be based on export prices in December 2014. The farmer accounts for the GST on the down payment as the time of supply for that payment has taken place on 11 October. The catch-up payment is accounted for when it is due, or received, or when an invoice is issued, whichever is the earlier.

- Tokens, stamps and vouchers — s 9(2A), (2B)

  A supplier should treat stamps, tokens or vouchers as a supply for GST purposes at the time a customer buys them. Generally, a supply takes place when tokens, stamps and vouchers are issued, not when the vouchers are redeemed. However, if s 5(11G) applies, the time of supply is at redemption. See ¶32-023.

- Uninvited direct sales — s 9(2)(b)

  The time of supply is the day after the five-day period within which the recipient may cancel the sale (under s 36M of the Fair Trading Act 1986).

¶32-027 Value of supply for GST [GST ss 2(1), 4, 10]

The value of a supply is significant because it is the amount upon which GST is calculated. For example, $15 GST is charged if the value of the supply is $100.

Calculating the value of supply

Section 10(2) provides the following formula for calculating the value of supply:

value of supply + tax charged = consideration (as defined)

Consideration

In most situations a supplier will require payment in money. In these cases "consideration" for the supply will usually be the agreed GST-inclusive price. This price is called "consideration in money". It appears that payment by means of an exchange rather than in money will still constitute "consideration in money" if the goods tendered in exchange are stated as having a precise monetary value.

Occasionally the consideration might be only partly expressed in money, or might not be expressed in money at all. For example, a shopkeeper might not charge his window-cleaner for certain supplies. If those supplies are not expressed as having a precise monetary value, reference must be made to the "open market value" of the supply to set the consideration or to make up the deficiency between the market price and the price charged. See *Case* T11 (1997) 18 NZTC 8,064.

Open market value

Consideration is determined by reference to the open market value if goods and services are supplied:

- at no, or inadequate, consideration, or
- for a consideration other than money.

Generally, the open market value is the price (including GST) that similar goods and services would fetch in similar circumstances if the supply was freely made and the parties to the transaction were not associated persons.

Inland Revenue (IR) sets out the criteria in *Tax Information Bulletin* Vol 6, No 14, June 1995 at 6.

If the open market value cannot be ascertained, the Commissioner is empowered to fix the value.

Book value is not an appropriate basis.

Like "consideration", "open market value" is always a GST-inclusive amount.

Definition of "consideration"

The definition in s 2(1) extends the ordinary meaning of the word; it does not have the same meaning that it has in general contract law.

The definition requires that the "consideration" be provided "in respect of, in response to, or for the inducement of, the supply of goods and services". It has been held that the phrase "in respect of" imports the notion of connection or relationship between the supply and the payment.

See *Trustee, Executors and Agency Co New Zealand Ltd v C of IR* (1997) 18 NZTC 13,076, *Chatham Islands Enterprise Trust v C of IR* (1999) 19 NZTC 15,075 (CA) and *Rotorua Regional Airport Ltd v C of IR* (2010) 24 NZTC 23,979.

Example:

A (a resident) and B (a non-resident) are associated persons. A's balance date is 30 June. A is GST registered on an invoice basis with two-monthly periods ending on December, February, April, June, August and October. B supplies services to A that are completed on 20 July 20X7 and these supplies, if made in New Zealand by a registered person, would be subject to GST at the standard rate. A estimates that the percentage intended taxable use of the services is less than 95%. No invoice has been issued by B for the supply and no payment has been made by A in relation to the supply. The time of supply for the reverse charge is 31 August 20X8. If a payment had been made or an invoice had been issued before 30 June 20X8, the time of supply would be the date on which the invoice was issued or the payment was made.

¶32-430 Value of supply of imported services for GST [GST s 10(3C), (3D), (3E), (15C)]

The value of the supply for imported services is the GST-exclusive amount of the consideration for the supply. For imported services provided by associated persons, the value of the supply will generally be its market value, except when the recipient of the supply can claim a deduction for the expense for income tax purposes (or could have claimed a deduction if consideration had been given). This generally applies to intra-group and inter-branch supplies. For supplies made within a group, the value of the supply excludes salary or wages paid and interest incurred by either the non-resident supplier or other group company. Also see ¶32-440 for companies that are group registered for GST.

¶32-440 Imported services and group companies, branches and divisions [GST ss 2A(1)(bb), 55(7B), 56B]

The rule allowing intra-group supplies to be disregarded does not apply to imported services provided by non-residents in the same GST group (see s 55(7) and (7B) of the Goods and Services Tax Act 1985). Where companies are group-registered for GST, services supplied by a non-resident in the GST group must be included in the nominated company's GST return.

There are also special deeming provisions for taxpayers operating through a branch or a division. A branch or division includes a head office. The deeming provisions are:

- each branch or division is treated as a separate person
- a branch or division inside New Zealand is treated as being a resident
- a branch or division outside New Zealand is treated as being a non-resident, and
- an activity carried on by a branch or division is treated as being carried on separately by the branch or division.

The deeming provisions apply whether a branch or division is separately GST-registered or not.

A person, or a branch or division of the person that is treated as a separate person, is associated with another branch or division of the person that is treated as a separate person.

The practical effect of the deeming provision and the inclusion of intra-group supplies is that once a liability for the reverse charge arises, there are no exceptions.

¶32-450 GST adjustments on changes to the supply of imported services [GST s 25AA]

In the case where a contract for the supply of imported services is wholly or partly cancelled or varied, the recipient of the supply must make an adjustment to the amount of output tax paid or input tax claimed in the return for the GST period in which it becomes apparent that the amount claimed was incorrect. Section 25AA provides that an adjustment must be made to the amount of GST returned and paid or GST deductions made if any of the following events occur:

- the supply of services is cancelled
- the nature of the supply of services has been fundamentally varied or altered

- the previously agreed consideration for the supply of services has been altered (whether because of the offer of a discount or otherwise), or
- the services (or part of the services) supplied have been returned to the non-resident.

The adjustment must be made in the return for the taxable period in which it becomes apparent that the output or input tax previously returned was incorrect.

¶32-460 GST record-keeping for supplies of imported services [GST s 24B]

The recipient of the imported services is also required to keep sufficient records to enable the following details to be ascertained:

- the name and the address of the supplier
- the date on which, or the period during which, the supply was received
- a description of the services that were supplied
- the consideration for the supply
- the time by which payment for the supply was required, and
- for intra-group services, the amount of the salary or wages and interest incurred that has been excluded from the consideration for the supply, in accordance with s 10(15C)(a), (b).

GOODS AND SERVICES TAX ON LAND TRANSACTIONS

¶32-500 Introduction to GST on land transactions [GST ss 2(1), 9(1), 19D]

Although virtually every commercial transaction involving real property will involve consideration of GST implications, there are some exceptions to this rule, for example, exempt supplies, such as the supply of residential accommodation (see ¶32-052).

Time of supply

Determination of the "time of supply" establishes the taxable period in which the supplier must account for GST to Inland Revenue (IR). The time of supply also fixes the point at which the purchaser can claim an input tax credit for GST charged. The accounting basis adopted by the parties determines the period in which GST must be accounted for or claimed as a deduction. For the invoice basis, the payments basis and the hybrid basis, see ¶32-078. The general time of supply rule states that a supply occurs at the earlier of the time an invoice is issued by the supplier or the recipient and the time any payment is received by the supplier in respect of that supply. In relation to the sale and purchase of land see below at ¶32-510 and ¶32-520.

Long-term settlements

Special rules apply to payments-based taxpayers involved in long-term settlements where the consideration exceeds $225,000. A vendor involved in such a settlement must account for GST on an invoice basis rather than a payments basis (although an exception applies for non-profit bodies — see below).

This approach is required if the agreement is *not* a "short term agreement for the sale and purchase of property or services". To be a short-term agreement, the general rule is that settlement must take place, or services must be performed, within 365 days of the date on which the agreement is entered into. See s 19D.