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Preface

The *2017 New Zealand Master Tax Guide* is an essential guide for tax practitioners and taxpayers preparing 2016 tax returns, working out 2017 provisional tax payments, and looking for an overview of changes made during the 2016/17 income year.

Anyone working in this area will know that tax law is always changing and that the rate of change seems to be increasing. All of the legislative amendments that occurred during 2016 have been incorporated into this edition of the *New Zealand Master Tax Guide*, including:

- new rules allowing companies to ''cash out'' their tax losses from research and development expenditure
- a new withholding tax on sales of residential property by offshore persons who sell the property within two years of acquisition
- tax deductions for certain ''black hole'' business expenditure
- new rules applying GST to cross-border remote services supplied by non-resident suppliers
- clarification of the position of bodies corporate and registration for GST
- remedial changes to the foreign superannuation rules, and
- changes to simplify the tax administration system as part of Inland Revenue's Business Transformation.

In addition, proposed legislative changes covered include:

- changes to the look-through company rules and the dividend rules as they apply to closely-held companies to simplify the rules and reduce compliance costs
- a number of reforms to the NRWT and AIL rules to ensure they apply as intended to related-party debt
- enabling businesses to recover GST incurred on goods and services used to raise capital
- allowing agreed alternative methods for applying the GST apportionment rules for certain taxpayers
- amendments to the debt remission rules
- amendments to allow commonly-owned companies to transfer imputation credits as part of loss grouping
- amendments relating to the timing of aircraft engine overhaul deductions
- an exemption from the land-tainting rules for organisations controlled by a local authority
- increasing the safe-harbour threshold for residual income tax to $60,000
- introducing an accounting income method for smaller taxpayers to pay their provisional tax

- allowing certain contractors to elect their own withholding rate, extending the schedular payment rules to contractors that work for labour-hire firms, and allowing other contractors to opt in to the rules
- removing the 1% incremental late payment penalty from GST, provisional tax, income tax and WfFTC overpayments
- extending the motor vehicle expenditure rules to certain close companies
- introducing a simplified method for the calculation of deductions for dual use premises and vehicles
- strengthening the disclosure requirements for foreign trusts, and
- implementing the G20/OECD standard for automatic exchange of information.

As with previous editions of the *Master Tax Guide*, we have retained these popular features:

- summaries of the changes affecting the 2016/17 tax year and future years in "The year at a glance" and "Looking Ahead"
- a calendar of important tax dates for the 2016/17 tax year, including provisional tax dates
- a table of tax rates, and
- a topic index, section finding list and case table.

As always, there will be new cases, rulings and legislation after publication of this Guide. To discuss our range of updating tax commentary products and services, please call CCH customer services on 0800 500 224.

To keep up to date with changes throughout the year, the *Updating Master Tax Guide* is the logical choice. That version, available online, is updated continuously during the year, with all changes integrated into the relevant chapters. In addition to having a powerful search capability, it provides useful links to the rulings, cases and legislation discussed in the commentary.

CCH wishes to thank the dedicated team responsible for this edition of the *Master Tax Guide*. Iona Jones was the writer, with valued assistance from the editorial team.

Our tax analysts are here to help if you have any questions arising from the contents of the *2017 New Zealand Master Tax Guide*. We value your feedback and thank those who have contributed ideas for improvement over the past year.

February 2017
CCH New Zealand Limited

Chapter 2 TAX RETURNS

¶2-010 Introduction to tax returns [TAA ss 33, 33AA]

Every taxpayer must furnish a return of income for a tax year except for certain multi-rate PIEs and those persons who are not required to file returns under s 33AA of the Tax Administration Act 1994. A tax year runs from 1 April to the following 31 March.

The Commissioner is required to give public notice of the dates when returns should be filed, though failure to give notice does not affect a person's liability to file a return by the due date. Notice is given by publication in the *Gazette*, and by newspaper and television advertising. Due dates are also shown on the return forms and information literature posted to most people. The Commissioner may extend the time within which a return must be furnished. However, any unfavourable exercise of that discretion is not open to challenge.

Certain individuals (who will not satisfy the requirements in s 33AA(2)) must furnish a return, such as provisional taxpayers, non-residents and those who have made a tax loss or have a tax loss carried forward. Companies and persons carrying on business for any part of an income year must also furnish returns, regardless of whether they have incurred a profit or a loss. Equally important is the capacity in which an individual has received income. For example, an individual might derive income personally, as the agent for a non-resident, in the capacity of trustee or as a member of a partnership. Different tax returns are required in each case. See ¶2-015.

The obligation is discharged only when the return is received by an Inland Revenue (IR) office. It is sufficient if the person can prove that a correctly addressed return was posted to the appropriate IR office. See *Martin Holdings Ltd v C of IR* (1973) 1 NZTC 61,081 (SC). See also *Case* T23 (1997) 18 NZTC 8,148, in which the Taxation Review Authority ruled that a tax return is furnished when it is received at IR's post office box.

ASSESSMENT AND COLLECTION OF INCOME TAX

¶2-015 Form and content of return [TAA ss 13B, 33(2), 34, 40, 42]

General content

A return must contain the information and must be accompanied by all the documents required under any of the Inland Revenue Acts. This includes a notice of self-assessment. In practice, Inland Revenue tax return forms contain a notice of self-assessment and declaration at the end of the form. Returns must be signed. For returns furnished electronically, an electronic signature is sufficient if the requirements in s 13B are met (see discussion in ¶1-645). Persons need not personally fill out and sign their own returns. A return made by or on behalf of any person is deemed to have been made by the person or on his or her authority, unless the contrary is proved. See ¶2-036.

Return types

The main returns are as follows.

Individuals

- Form IR 3 is for self-employed individuals and others who pay provisional tax on investment or business income (including partners). Some private domestic workers (eg nannies or gardeners) who pay tax as IR 56 payers may have to file an IR 3 return.
- Form IR 3B (supplementary to form IR 3) is for business or professional taxpayers trading on their own account with business income, who are required to analyse their income and deductions.
- Form IR 3F (supplementary to form IR 3) is for taxpayers carrying on a farming business on their own account.
- Form IR 3NR is for non-residents.

Companies

- Form IR 4 is for companies, incorporated societies, public authorities, unit trusts, certain group investment funds and state enterprises liable for tax. (Note that only one return is required for companies within a consolidated group.)
- Form IR 4F is used if the company keeps an FDP account.
- Form IR 4J is used if the company is required to keep an imputation credit account.
- Form IR 4S is for company shareholders' details.

Trusts and estates

- Form IR 6 is for trustees in relation to trust and estate income. (When an estate has income from a farming business, form IR 3B or IR 3F can also be used.)
- Form IR 6B is required if income is distributed to beneficiaries.
- Form IR 307 is used if distributions of beneficiary income or taxable distributions are made to beneficiaries from a foreign or non-complying trust.

Partnerships

- Form IR 7 is for partnerships and form IR 7P is used for partnership income/loss distribution (see ¶2-050). In addition, partnerships must also file one of the following:
  - a financial statements summary (form IR 10)
  - a set of the partnership's financial statements
  - a completed form IR 3F (farming) or IR 3B (business income), if applicable.

Each partner must file a personal tax return (form IR 3) with all income including a share from the partnership. The partnership is not assessed for tax, but each partner is liable to pay tax on his or her share of income.

Look-through companies (LTCs)

Form IR 7 is also for LTCs and IR 7L is used to show the LTC income/loss distribution. In addition, LTCs must also file one of the following:

- a financial statements summary (form IR 10)
- a set of the LTC's financial statements
- a completed form IR 3F (farming) or IR 3B (business income), if applicable.
  See further at ¶19-240.

Other

- Form IR 8 is for Maori authorities.
- Form IR 9 is for clubs and societies.

- Form IR 44 is for registered superannuation funds.
- Form IR 44E is for group investment funds.

An individual may be required to file several different returns according to the particular capacities in which he or she acts.

Example:

Mr TP is a partner of a four-member law firm. He owns several properties in his own name which he rents out. He also acts as a trustee for several trusts established on behalf of his clients. Mr TP would need to ensure that he filed the following returns of income:

- form IR 3, which would include his share of partnership income and the rents received from his properties
- form IR 6, of which a separate form would need to be filed for each of the trusts for which Mr TP acts as trustee
- form IR 6B, if any income is distributed to beneficiaries, and
- form IR 7, which would include the income earned by the law firm of which Mr TP is a partner.

As a variation on these facts, if some of the rental properties were owned by a family company and some jointly with his wife in partnership, Mr TP would need to ensure that the following returns were also filed:

- form IR 4, which would include the rental income earned by the family company
- form IR 4J, and
- form IR 7, which would include the rental income earned by Mr TP and his wife in partnership.

¶2-016 Individual tax return — a worked example

The practical example below demonstrates how the tax payable by or refundable to an individual taxpayer for the tax year ended 31 March 2017 might be calculated.

Example:

Jenny is a full-time employee of a local company. For the tax year ended 31 March 2017 she had a gross salary of $35,000 and pay as you earn (PAYE) of $5,250 (excluding Accident Compensation Corporation (ACC) earner levy). She is married to Bruce, a real estate agent, who earns approximately $65,000 pa in commission and salary. They have two children at primary school.

Jenny has the following additional sources of income during the tax year:

- Interest was credited to her account by the bank. The gross amount of interest was $125. Resident withholding tax was deducted by the bank from this amount. The bank held her Inland Revenue number.
- The sum of $5,200 was received as a court-ordered maintenance payment from her former husband.
- Jenny received payments of $900 from the ACC during a period she was unable to work. This was because of an accident incurred while she was on a recreational hike.
- While at work Jenny took her wedding ring off during cleaning and lost it. Her insurance policy covered this loss and has paid out $300 on her claim.
- She also received a travel allowance of $150 from the company to reimburse her for the additional cost of getting to work on Sundays when there was no bus service available. This was not included in her summary of earnings.

Jenny incurred the following expenditure during the tax year, and this expenditure was not reimbursed by the company she worked for:

- travelling to work, $550
- dry-cleaning of work clothes, $70
- the fee for determining her income tax liability, $120 (see Note 1).

Jenny has receipts for the following donations made during the tax year:

- $20 to the Red Cross
- $25 to the Foundation for the Blind
- $12 to the National Party
- $15 to the Hamilton East Soccer Club
- $10 to Amnesty International
- $100 to the Hamilton East Primary School ($60 for school fees and $40 as a general donation).

	$	$	$
Annual gross income (ss BC 2, BD 1, BD 3)			
Salary (employment income, s YA 1) (s CE 1(1)(a))			35,000
Interest received (s CC 4)			125
Earnings-related compensation (ACC) (s CF 1(1)(a))			900
			36,025
Excluding personal income:			
insurance recovery			
Excluding exempt income (subpart CW):			
reimbursing travel allowance (s CW 18)			
payment for court-ordered maintenance (s CW 32)			
Less annual total deduction (s BC 3):			
determining tax liability, see Note 1 (s DB 3(1))			120
Equals net income (loss) (s BC 4)			35,905
Less available tax losses (s BC 5)			0
Equals taxable income (s BC 5)			35,905
multiplied by basic tax rate (sch 1 pt A), 10.5% up to $14,000, 17.5% from $14,001 up to $48,000			
Equals income tax liability before use of tax credits (ss BC 8, LA 2)			5,304
Less:			
Non-refundable credits (s LA 4)	0		
Refundable credits (s LA 4)	0		
PAYE (ss LA 6, LB 1)	5,250		
Resident withholding tax (s LA 6)	22		
			5,272
Equals:			
Terminal tax (ss BC 8(3), LA 1–LA 4)			0
Remaining credits (s LA 5)			
Amount owing by the person			32

Notes:

(1) Even though Jenny is not required to file a return for the 2017 tax year because the correct amount of tax has been withheld from her income at source, the fee charged by her tax advisor for determining her tax liability and tax credit entitlement would be deductible under s DB 3.

(2) The charitable donations tax credit is excluded from the determination of a person's income tax liability. To claim this tax credit, a separate claim form (IR 526) must be completed and filed with the income tax return. The resulting refund could be transferred to meet Jenny's tax obligation. See ¶11-060.

¶2-017 Dates for furnishing returns [TAA ss 37(1), 40(3)]

The due dates for the filing of annual returns of income are:

- 7th day of the 4th month after the end of the person's corresponding income year for any person with a late balance date (ie 1 April to 30 September), and
- 7 July for all other persons.

Note that these dates do not apply to persons who have their returns prepared and filed by tax agents. See ¶2-018.

When received in time

A tax return is treated as being filed only when it has been received at an Inland Revenue office.

Example:

This section was considered by the Taxation Review Authority where it was held that a tax return was delivered to the Commissioner when it was received at his private bag at the Post Office. See *Case* T23 (1997) 18 NZTC 8,148.

¶2-018 Extension of time to file returns [TAA ss 34B, 37]

Any person can apply to the Commissioner for an extension of time to furnish an annual income return. This is likely to occur where the person does not have an extension of time arrangement through a tax agent (see below). Provided the application (which can be made verbally or in writing) is made before the due date for filing the return, the Commissioner may grant the extension if she thinks it "proper in the circumstances". Standard practice statement SPS 09/03, "Extension of time applications from taxpayers without tax agents", published in *Tax Information Bulletin* ¶219-113 Vol 21, No 9, December 2009 at 27, gives the following examples of reasons Inland Revenue (IR) considers appropriate for extending the filing date:

- the person is unable to obtain the necessary information to file the return (eg is waiting to receive a summary of earnings from IR)
- the person has been overseas and needs extra time to prepare a return (depending on departure and returning dates)
- ill health, hospitalisation or injury of the person or the person's family member (eg partner or dependant), and
- the person is awaiting the finalisation of financial statements for a related person with a different balance date.

IR will also take into account the person's history of filing returns.

Tax agents

The Commissioner can also grant extensions to tax agents. A tax agent is a person who is eligible to be a tax agent and who is listed as a tax agent by the Commissioner. To be eligible to be a tax agent, the person must prepare the returns for 10 or more taxpayers and be a person who is:

- a practitioner in a professional public practice
- carrying on a business or occupation in which returns of income are prepared, or
- the Maori Trustee.

To be listed as a tax agent the Commissioner must be satisfied that the person is entitled to be a tax agent and that the listing will not adversely affect the integrity of the tax system.

Statutory declaration

From June 2014, a new procedure has been introduced to apply to be a tax agent that takes the form of a statutory declaration. An individual now has to complete form IR 791, "Statutory declaration to be a listed tax agent or update a tax agent's details". The form must be witnessed and sent to IR with a list of at least 10 return-filing clients. A copy of the individual's proposed authority letter also needs to be attached. For a non-individual, or entity, a key office holder must complete a "Statutory declaration of a key office holder in support of an application to be a listed tax agent" (IR 768). This also needs to be witnessed and sent to IR with a list of at least 10 return-filing clients and a copy of the proposed authority letter.

Key office holders

Key office holders for the following include:

- body corporate (other than a closely held company)
  - Tax manager
  - Chief Financial Officer
  - Chief Executive Officer, and
  - Directors
- closely held companies
  - all shareholders
- partnerships
  - all partners
- unincorporated bodies
  - each member of the entity.

Extension of time for tax agents

The Commissioner may extend the time for filing for tax agents to not later than one of the following days:

- where the return is for any year ending between 30 September and the following 31 March, the day is the next succeeding 31 March, or
- where the return is for any year ending between 31 March and 1 October, the day is the following 31 March.

The Commissioner may cancel an extension of time arrangement if a tax agent has not filed the required number of tax returns by the dates that the Commissioner has specified. If a tax agent has not negotiated personal guidelines, then the standard interim dates set by the Commissioner apply. For example, in relation to the filing of 2016 income tax returns, IR has set three interim dates throughout the year by which tax agents have to file a certain percentage of their clients' tax returns. The outcome is that the Commissioner can cancel the extension of time arrangement if the targets are not met.

¶2-019 Electronic filing of returns [TAA ss 23, 36, 36C, 36CA, 40]

The Commissioner may give approval to any person or GST-registered person and/or the person's agent to file information electronically. The return must be filed in the prescribed format and approval may be subject to any conditions specified by the Commissioner.

Where the return has been filed electronically, a signed, hard-copy of the return does not need to be retained if the information is kept in an electronic form meeting the requirements of s 25 of the Electronic Transactions Act 2002. The information must be retained for at least seven years.

An agent may sign any hard-copy form of a return where the return is filed electronically.

Inland Revenue is able to accept most income tax returns (IR 3, IR 4, IR 6, IR 7, IR 8 and IR 9), monthly schedules and correspondence by electronic means, including details required under the provisional tax pooling provisions or in relation to the operation of the person's environmental restoration account. The Commissioner may also approve electronic filing of GST returns. GST and FBT returns (see ¶21-030) can also be filed online. A return or information furnished by electronic means must be transmitted in an electronic format prescribed under s 36, 36A, 36AB, 36B, 36BB or 36BC of the Tax Administration Act 1994 (see s 36C).

Employers with a combined PAYE and employer's superannuation contributions tax bill of $100,000 or more for the preceding tax year must file their employer monthly schedule electronically unless they obtain a special dispensation from the Commissioner. See ¶3-022. There is a penalty for non-electronic filing (see ¶14-045), although new businesses starting up are given a six-month leeway period (see s 36CA).

¶2-020 Miscellaneous returns [TAA ss 62, 70, 79, 80]

Individuals who are required to furnish a return of income must select the return of income form appropriate to their circumstances. There are a number of different forms prescribed for different persons; for example, fringe benefit tax returns (IR 420, IR 421, IR 422) and the GST return (GST 101A) where the individual or entity is an employer and also registered for GST. Some of the more commonly used forms are available on the Inland Revenue website: www.ird.govt.nz.

The Commissioner has the power to requisition the following returns:

- an annual ICA return (form IR 4J) from companies for any period specified by the Commissioner
- returns from companies, local or public authorities in relation to interest paid on debentures
- special returns from certain taxpayers (eg agents, non-residents and executors — see further under ¶2-050).

In addition to the specific filing requirements set out above, the Commissioner is empowered to request any further annual or other return from any person (taxpayer or not) for the purposes of the Tax Administration Act 1994 or the Income Tax Act 2007. See ¶2-050.

¶2-026 Non-active companies and returns [TAA s 43A]

Non-active companies may elect not to file a return. To apply for the exemption, a company must declare that it is a non-active company and that it will notify the Commissioner if it ceases to be so. A non-active company for these purposes is one that has not derived any income, has no deductions, has not disposed, or deemed to have disposed, of any assets and has not been a party to any transaction that gives rise to deemed income in any person's hands, a debit to the company's imputation or FDP account, or fringe benefit to an employee. Companies incorporated for name protection purposes or to be available as shelf companies will generally be entitled to the concession.

Where a company ceases to be non-active the Commissioner must be notified, along with information regarding any tax losses and change in ownership. The Commissioner has the power to require a non-active company to file a tax return or imputation return despite the company's status as a non-active company.

A New Zealand-resident company with a standard balance date is not required to file an imputation credit account return for a tax year during which it is a non-active company. Similar concessions exist for New Zealand-resident companies with non-standard balance dates.

¶2-027 Non-active trusts and returns [TAA s 43B]

With effect from 16 November 2015, non-active trusts may elect not to file a return. To apply for the exemption, throughout the tax year, the trust must be a non-active complying trust and a trustee must have declared that the trust is a non-active trust and that it will notify the Commissioner if it ceases to be so.

A trust is non-active if, throughout the tax year, the trustee:

- has not derived or been deemed to derive any income
- has no deductions, and
- has not been a party to, or perpetuated or continued with, any transactions with assets of the trust that, during the tax year, give rise to income in any person's hands or fringe benefits to any employee or former employee.

Certain minimal amounts of income or deductions can be ignored in determining whether a trust is non-active. This includes:

- reasonable fees paid to professional trustees to administer the trust
- up to $200 of bank charges or other minimal administration costs in the tax year
- up to $200 of interest earned on trust assets in a bank account in the tax year, or
- insurance, rates and other expenditure incidental to the occupation of a dwelling owned by the trust and incurred by the beneficiaries of the trust.

Where a trust ceases to be a non-active trust, the Commissioner must be notified. The Commissioner retains the power to require a non-active trust to furnish a return, despite its non-active status.

¶2-028 Non-filing taxpayers [TAA ss 33AA, 33C]

Individuals are neither required to file tax returns nor will they automatically receive an income statement (see ¶2-029) from the Commissioner, if they have derived assessable income only from:

- employment that is subject to pay as you earn (PAYE) deductions
- interest or dividends subject to resident withholding tax (RWT)
- interest or dividends that do not have a New Zealand source
- a taxable Maori authority distribution (see ¶24-288)
- a schedular payment (see ¶3-044), or
- any other source not listed above if the total amount derived is $200 or less

and their total income from the following items does not exceed $200:

- Employment income subject to inadequate PAYE or Accident Compensation Corporation (ACC) earner levy deductions.
- Interest or dividends derived from offshore unit trusts, an extra pay or income from secondary employment earnings, from which the RWT or tax (as applicable) has been withheld at a rate other than:

17.5%	if the individual's annual gross income is	between $14,001 and $48,000
30%	if the individual's annual gross income is	between $48,001 and $70,000
33%	if the individual's annual gross income is	over $70,000

- A taxable Maori authority distribution if the individual's annual gross income exceeds $48,000 (see ¶24-311).
- Interest, dividends or taxable Maori authority distributions of a person required to pay child support.

- An election day worker's salary or wages if the worker has used the "EDW" tax code.
- A casual agricultural worker's salary or wages if the worker has used the "CAE" tax code.
- Foreign-sourced interest or dividends, excluding dividends derived from offshore unit trusts from which RWT has been withheld.

In addition, to satisfy the non-filing requirements in s 33AA(1), the person must:

- derive no income from employment for which the amount of tax deducted at source is determined by a special tax code
- be someone to whom the social assistance measures described in s 33AA(1)(o)–(p) of the Tax Administration Act 1994 (TAA) do not apply (generally, Working for Families tax credits)
- be a resident
- not be a provisional taxpayer
- be a cash basis person
- derive $200 or less of income that included:
  - a schedular payment (unless all or part of the amount received has been determined by the Commissioner to be a reimbursement of expenditure (see ¶3-457), or
  - beneficiary income
- derive no income for providing personal services to a claimant under the Accident Compensation Act 2001 or satisfy the requirements of s 33C of the TAA (see discussion below)
- have no tax loss balance or tax loss component (other than a tax loss component under s LE 2 of the Income Tax Act 2007)
- have no loss balance
- not hold an exemption certificate under the RWT rules at any time in the tax year
- derive no interest payment for which RWT is capped under the rules for an inflation-indexed instrument
- have not carried forward a credit of tax that has arisen from the receipt of excess imputation credits (see ¶2-110)
- not be required to furnish a return under s 44, and
- not be a person the Commissioner considers should furnish a return.

If the individual cannot satisfy any of these requirements, the non-filing exemption will not apply and the person will be required to file a return.

Non-resident seasonal workers are not required to file an income tax return at the end of the year but may choose to do so.

Personal service rehabilitation payments

A natural person who derives income in an income year from providing personal services to a person who is a claimant under the Accident Compensation Act is not required to furnish a return of income for the tax year if:

- a personal service rehabilitation payment is made for the claimant and for the personal services
- the person's taxable income for the year does not exceed $14,000
- tax is withheld at the rate of 10.5% by the ACC from the personal service rehabilitation payment, and
- the person meets the requirements of s 33AA(1) for the tax year, ignoring the income from providing personal services for which personal services rehabilitation payments are made.

¶2-029 Income statements [TAA ss 80A–80D]

Most individuals who receive salary and wages, interest or dividends will have their final income tax liability determined by means of an income statement (commonly referred to as a personal tax summary) instead of being required to file an annual tax return. Broadly, an income statement is a statement issued by the Commissioner that contains particulars about a taxpayer's income and tax withheld.

A non-filing taxpayer (see ¶2-028) may request that the Commissioner issue an income statement for a particular tax year. Once an income statement is issued, it is deemed to be a return of income with the result that the taxpayer may have tax to pay or a refund owing (see ¶2-032).

The Commissioner must issue an income statement to a non-filing taxpayer who requests an income statement, or to a non-filing taxpayer who is required to file an employer monthly schedule because their employer is not required to withhold tax for a PAYE income payment to the person. The Commissioner may also issue an income statement to a person, or require a person to request an income statement, at any time if the Commissioner considers that the person has derived income in a tax year.

The Commissioner may issue more than one income statement for a tax year to a person.

Taxpayers are under no obligation to request an income statement except in limited circumstances. The Commissioner has published a list of taxpayers who may not necessarily be issued with an income statement but who must request one (see *Tax Information Bulletin* ¶226-103 Vol 22, No 6, July 2010 at 5).

Taxpayer to notify IR of statement wrongly sent

Individuals who have been mistakenly sent an income statement must inform IR of IR's error by the individual's terminal tax date for the tax year to which the income statement relates. These dates are set out in sch 3 pt A, column G or H (see ¶50-015).

¶2-030 Particulars to be included in income statement [TAA s 80E]

All income statements must contain the following details:

- the individual's annual gross income for the tax year derived from employment, interest and dividends and details of the income source
- the amounts of tax withheld for PAYE income payments and other income made in relation to the annual gross income for the tax year
- the amount of earner levy deducted in respect of that person
- a calculation of that person's income tax liability, including any tax payable or refund due
- particulars relating to Working for Families tax credits, and
- any further particulars the Commissioner considers necessary,

subject to that information being available and applicable to the person's circumstances.

¶2-031 Taxpayer obligations and assessments on receipt of income statement [IT07 s RM 5; TAA s 80F]

Once an income statement has been issued, there may be further obligations for an individual taxpayer or Inland Revenue.

Individuals must notify the Commissioner of any error in the income statement with the necessary corrections unless the amount of annual gross income for the tax year derived from employment, interest or dividends that is not included in the income statement is under $200. Note that for these purposes, any interest income that has not been subject to RWT will fall outside the $200 threshold.

Notification must be made by the later of the person's terminal tax date for the tax year to which the income statement relates, or two months after the date of issue.

Chapter 7 LAND TRANSACTIONS

¶7-010 Categories of land disposals subject to taxation

[IT07 ss CB 6A–CB 23B, DB 23]

Provision is made within subpart CB of the Income Tax Act 2007 for income to include receipts from the disposal of land in various circumstances. Broadly, there are nine categories of land disposals that give rise to income. Each category is subject to exclusions that, if applicable, operate to prevent the category-creating income.

The categories of land disposals that give rise to income are the following:

- for residential land first acquired on or after 1 October 2015, acquired and disposed of within two years
- purpose or intention of sale
- a business relating to land that encompasses dealing, developing or erecting buildings
- dealer's other land
- developer's other land
- builder's other land
- development or division commenced within 10 years
- major development or division
- rezoning changes, and
- landfills.

Exclusions

These categories of income from the disposal of land are subject to the exclusions set out in ss CB 16A–CB 23. The effect of an exclusion is that an amount that is otherwise income under ss CB 6A–CB 15 ceases to be income under one of those provisions. This statutory approach leaves at large the position under other provisions of the Act. The exclusions encompass the following:

- main home exclusion for residential land disposed of within two years of acquisition
- residential exclusion for taxpayer's own residence
- a development or division of land for residential use
- rezoning gains if disposal is for residential purposes

- business premises
- development or division for the business
- development or division if disposal is for farming purposes
- farming purposes and rezoning gains, and
- development or division of investment land.

Interaction of land disposal provisions with other provisions

The land disposal provisions apply if their requirements are satisfied. They are not subject to an implied limitation that would prevent their application to gains that may otherwise be regarded as of a capital nature. See *Lowe v C of IR* (1981) 5 NZTC 61,006 (CA). The land disposal provisions capture gains of a capital nature, as the category relating to rezoning changes illustrates.

The interaction of the land disposal provisions with other provisions of the Act concerning assessable income may be unclear in some cases. There are no specific provisions that address the topic.

A first proposition is that the land disposal provisions are not an exhaustive code for the taxation of the sale of land. There is no provision that prevents gains derived from the sale of land forming part of assessable income as amounts derived from a business, from a profit-making undertaking or scheme or as income under ordinary concepts.

Example

A husband and wife and their family company purchased several residential houses with the intention of holding them as long-term investments for the couple's retirement. Financial difficulties compelled the sale of 20 properties over a two-and-a-half year period. The Commissioner assessed the profits from the sale of 17 of those properties over the 1990–1992 income years. The Commissioner submitted that gains from the sale of the properties were assessable income on any one of the following bases:

- business profits
- gains from an undertaking or scheme entered into for the purpose of making a profit, or
- income derived from any other source whatsoever.

The Taxation Review Authority held that the profits were not assessable income. The sales were not part of any business of buying or selling properties, but were to wind down the letting business. The Authority also held that there was no undertaking or scheme involving the purchase and resale of realty for profit. The Authority observed that unless profits from land dealings are clearly derived from land as circulating capital, the profits will almost certainly be capital rather than revenue. See *Case* S86 (1996) 17 NZTC 7,538.

Significantly, in *Case* S86, the Authority did not take the approach of holding that the absence of the application of the land disposal provisions necessarily prevented the application of the more general provisions on assessable income. Despite the land disposal provisions not having application, it continued to be necessary to consider whether other provisions of the Act rendered the gains made assessable income.

A second proposition is that it may be appropriate to regard the land disposal provisions as the only provisions of possible application in some situations. For example, the application of the exclusion for the business premises for a dealer or developer may be regarded as ending any enquiry as to whether the disposal results in assessable income. The application of some other provision to yield assessable income would undermine the exclusion.

Similarly, the provisions on major subdivisions prescribe market value as the cost base for calculation of the assessable income. It would undermine the provisions on market value for it to become the case that assessable income should be calculated on the basis of historical cost under the provisions taxing business profits.

For a more detailed commentary on land transactions, see R Thompson and M van den Berg *A Practical Guide to Taxing Property Transactions* (5th ed, CCH, Auckland, July 2014).

Disposal of land at a loss

The land disposal provisions do not address the deduction of a disposal of land at a loss. The land may be regarded as revenue account property because its disposal produces income. A deduction is allowed under s DB 23 (see ¶7-360) for the cost of revenue account property despite the capital limitation. Simultaneous recognition of the sale proceeds would effectively confer a deduction for the loss. That is also the position under the general law. See *C of IR v Inglis* (1992) 14 NZTC 9,180 (CA).

¶7-015 Recent proposals

The Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Bill, introduced into Parliament on 3 May 2016, proposes to amend the land tainting rules to exempt entities linked by ownership or control to local authorities.

The land tainting rules were introduced to prevent tax avoidance, but are overreaching in the context of council groups by taxing capital account land in situations when there is no tax avoidance concern.

The amendment is intended to apply from 1 September 2015, the date on which Auckland Council established a land development entity. The amendment will prevent land held by council-controlled organisations of Auckland Council from being tainted by the land development entity.

The exemption is not intended to apply to:

- entities associated with a local authority under the tripartite relationship test in s YB 14, and
- entities associated to a property developer when that developer is outside the council group, unless that association occurs under s YB 14.

Consequential amendments are also proposed to ss CV 2 and FM 9 to ensure that those provisions are overridden by the proposed new s CB 15C, otherwise a land disposal that was exempt under s CB 15C could still be taxable to the group because of the development activities of another group member. This will ensure that the consolidated group rules do not defeat the intent of the land tainting amendments.

¶7-018 Tax statement required on transfer of land [TAA ss 3, 24BA, 81; LT ss 156A–156J]

Following announcements made as part of Budget 2015, with effect from 1 October 2015, all transferors and transferees of real property must provide a tax statement as part of the conveyancing processes under the Land Transfer Act 1952.

A tax statement must contain the following:

- full name, date and signature of the transferor or transferee
- whether the land has a home on it
- whether the person or a member of their immediate family is a New Zealand citizen or visa-holder
- if the person is a transferee and they or their immediate family has a work or student visa, whether they intend living on the land, and
- either:
  - the category of exemption that applies (ie if the transfer is a non-notifiable transfer), or
  - the person's Inland Revenue (IR) number and, if the person is a tax resident in another jurisdiction at the time of the transfer, the name and country code of that jurisdiction and the equivalent of an IR number (the "tax identification number" or TIN) from that foreign jurisdiction.

Where a person is acting in another capacity (for example, as trustee of a trust), the tax statement provided must relate to the capacity in which they are acting. Nominees must provide details of the principal.

Main home exemption from requirement to provide certain information

The requirement to provide the person's IR number as part of a tax statement does not apply to a New Zealand individual (who is not an "offshore person" as defined in the Tax Administration Act 1994) transferring their main home. This is because it is a non-notifiable transfer.

For the main home information exemption to apply for a transferee, the land must be intended to be used predominantly for a dwelling that will be the transferee's main home. For the main home exemption to apply for a transferor, the land must have been used predominantly, for most of the time the transferor owned the land, as a dwelling that was the transferor's main home. The owner must intend to reside, or have resided, in the property as their main home. Accordingly, the exemption will not apply when only a family member will use, or has used, the property as their main home, and not the owner themselves. The test is applied at the date of transfer and applies for each transferor or transferee.

Example 1:

George buys his first home in Seymour Street in 2016. However, his neighbours complain about the noise when he plays his drum kit, so he decides to sell it and buy a new home with better soundproofing. When he puts his Seymour Street house on the market he is pleasantly surprised to discover that his house has risen in value. He has an offer accepted on a new house in Taradale Street. George does not need to provide his IR number for the sale of the Seymour Street property, which he lived in as his main home, or the purchase of the Taradale Street property, which is to be his main home.

Example taken from *Tax Information Bulletin* ¶2710-103 Vol 27, No 10, November 2015 at 10.

Exemption excluded

The exemption is not available where any one of the following applies:

- the person is an "offshore person" (see discussion below)
- the property is to be owned via a trust (in the case of a transferee)
- the property was owned via a trust (in the case of a transferor), or
- the main home exemption has been used twice or more in the two years immediately preceding the date of transfer.

Example 2:

Sarah is a New Zealand citizen who has been living in the United Kingdom (UK) for the past 10 years. Prior to returning to New Zealand, she decides to buy a house in Te Awamutu to live in. As she is an "offshore person" at the time she purchases the house, she cannot use the main home information exemption for this property and she will need to supply her IR number in relation to the purchase of that property. Because she is a tax resident of the UK at the time that she purchases the property, she will also need to supply her UK National Insurance number (which is the equivalent to a New Zealand IR number), and the UK country code.

Example taken from *Tax Information Bulletin* ¶2710-103 Vol 27, No 10, November 2015 at 11.

Used as home for "most of the time"

For the transferor, the land must have been used for most of the time that the person owns the land as their main home. IR has indicated this requires the property to have been used more than 50% of the time as their main home for the period the person owns the land. The land does not need to have been used without interruption as their main home.

Mixed use properties

Where a property is used as both a main home and for other commercial, investment, or farming purposes, the main home information exemption will be available where most of the land is used for the home. When less than 50% of the property is used for the main home of the person then the main home exception will not apply.

Example 3:

Judy owns a country store that has living quarters attached. She lives in the living quarters and runs a retail business from the front half of the property. She estimates that the retail business uses 45% of the property and claims expenses (for example, insurance and rates) on that basis against the retail income. Judy sells the property. She does not need to provide her IR number because she has used the property predominantly (55%) as her main home during the time she has owned the property.

Example 4:

Brandon intends to buy a fish and chip shop with an attached dwelling. Brandon will need to determine the total area of the different parts of the property to determine whether he intends to use the property predominantly for his main home, and so whether he needs to supply his IR number as part of the purchase. (Brandon will need to make an estimation of the total area in the future in any event to determine the deductions that can be claimed against his retail income.) Brandon estimates that he will use the property (building and surrounding land) 60% for the fish and chip shop. He will, therefore, need to provide his IR number on purchase of the property.

Examples taken from *Tax Information Bulletin* ¶2710-103 Vol 27, No 10, November 2015 at 11.

Multiple homes

Where a person resides in multiple homes, only one of those properties can be their main home. Their main home would be determined according to which property the person has the greatest connection with. The factors that determine these connections would include:

- the time the person occupies the dwelling
- where their immediate family, if any, live
- where their social ties are strongest
- the person's use of the dwelling
- the person's employment, business interests and economic ties to the area where the dwelling is located, and
- whether the person's personal property is in the dwelling.

The factors are similar to those used to determine if a person has a permanent place of abode under current case law. IR has stated that existing guidance on the "permanent place of abode" test should assist in determining which property the person has the greatest connection with.

Example 5:

Mr and Mrs Brown and their children live in a house on a small lifestyle block in Oamaru. Mrs Brown works in Christchurch for three days a week, and works from the Oamaru house two days a week while her husband looks after the children full-time. Mrs Brown plans to buy an apartment in Christchurch city. She will live in that apartment while she works in Christchurch.

Taking into account the fact that the majority of Mrs Brown's time is spent at the Oamaru house, and her family is located at the Oamaru house, the main home information exemption will not apply in relation to Mrs Brown's Christchurch apartment as it is not the home with which she has the greatest connection, and she will have to supply her IR number in relation to the purchase of that property.

However, if Mr and Mrs Brown were to sell their Oamaru property, they would not need to provide their IR numbers in relation to that sale because that property was their main home.

Example taken from *Tax Information Bulletin* ¶2710-103 Vol 27, No 10, November 2015 at 10.

Example 6:

Tom buys an apartment block on a single title. He lives in one of the apartments as his main home and rents out the remaining six apartments. Tom sells the apartment block to a third party. Tom will have to provide his IR number on the sale of the apartment block because the land (contained on the single title) was not used predominantly as his main home. The majority of the land was used as rental property.

Example taken from *Tax Information Bulletin* ¶2710-103 Vol 27, No 10, November 2015 at 11.

Other exemptions from requirement to provide certain information

Additional non-notifiable transfers (where there is no requirement to provide IR and TIN numbers) may be specified under regulations provided they meet certain criteria.

Cabinet has approved regulations that will provide an exemption from providing an IR number in the following situations:

- where a transfer is the result of a mortgagee sale, a rating sale under the Local Government (Rating) Act 2002, a court-ordered or statute-ordered sale, the transferor does not need to provide an IR number
- in the case of death, the executors of the person's estate are exempted from the requirement to provide an IR number
- tax-exempt public and local authorities will not need to provide an IR number when transferring land.

In addition, Cabinet has approved regulations to exempt transfers of Maori Land and also to exempt transferees from the requirement to complete a tax statement where the transfer is a part of the Treaty settlement process. These exemptions are for practicality reasons.

Information disclosure and retention

The information will be collected by conveyancers from property vendors and purchasers, and provided to Land Information New Zealand, which will in turn provide the information to IR. The onus is on vendors and purchasers to provide accurate information. Conveyancers do not need to certify the accuracy of the information but they are required to provide it before certifying the property transfer.

Offence to supply misleading or false tax information

A person who knowingly, or with intent to deceive, gives false or misleading tax information, commits an offence. They are liable to a fine not exceeding $25,000 for a first conviction and $50,000 for any subsequent convictions. If they provide information they genuinely believe to be true, but that is not in fact correct, they will not be committing an offence.

Application of new requirements

Note that although the provisions generally apply from 1 October 2015, they also appied to a transfer of land where the contract was entered into before 1 October 2015 if the transfer was not registered on or before 1 April 2016.

Requirement for offshore person to hold a bank account before obtaining IR number

Section 24BA provides that the Commissioner must not allocate an IR number to an "offshore person" who requests one unless the Commissioner first receives a current bank account number for the offshore person. The bank account can be with a registered bank or a licensed non-bank deposit taker, but must have gone through the appropriate anti-money laundering due diligence checks.

The bank account requirement applies only in instances where a person has applied for an IR number. This is so that the current practice of the Commissioner allocating IR numbers as an administrative matter in some cases will continue.

Meaning of "offshore person"

An "offshore person" is:

- for an individual:
  - New Zealand citizen who is outside New Zealand and has not been in New Zealand within the last three years
  - a person who holds a residence class visa granted under the Immigration Act 2009 and who is outside New Zealand and has not been in New Zealand within the last 12 months, or
  - a person who is not a New Zealand citizen and who does not hold a residence class visa
- for a body corporate or an unincorporated body of persons, including a trust or unit trust, a person who would be an overseas person under s 7(2)(b) to (f) of the Overseas Investment Act 2005, treating references to an overseas person or persons in that section as including a person or persons described above — in general, body corporates incorporated outside New Zealand or non-individuals that are 25% or more owned or controlled by offshore individuals.

Becoming an offshore person

Note that where a non-individual has an existing IR number and they become an offshore person after 1 October 2015, they must provide their current bank account number to the Commissioner immediately if they have not done so already. This does not apply to individuals, so that a New Zealand citizen who emigrates will not be obliged to provide a bank account number after being away for three years.

Wider application than compliance in land dealings

Although s 24BA was enacted as part of the property tax measures announced by the government in Budget 2015, the provision is wider than just tax compliance in land dealings. It is also intended to promote the enforcement of tax obligations of offshore persons generally. The changes are intended to give IR greater assurance about the identity of offshore persons by ensuring non-residents looking to obtain an IR number are first subjected to New Zealand's anti-money laundering rules.

Exceptions to requirement to provide current bank account

With effect from 14 May 2016, there are two exceptions to the requirement for an offshore person to provide a current bank account number before being issued an IR number. These exceptions apply to the following:

- a person who requires an IR number only because they are a non-resident supplier of goods and services under the Goods and Services Tax Act 1985
- a person for whom a reporting entity under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 has conducted the customer due diligence procedures required under that Act.

¶7-020 Residential land withholding tax

[IT07 subpart RL, ss LB 6B, YA 1; TAA ss 54B–54E, 81(4)(ob)]

The residential land withholding tax (RLWT) applies to the sale of "residential land" in New Zealand by an "offshore person" where the land was acquired on or after 1 October 2015 and owned for less than two years before being sold. This withholding tax ensures tax is paid under the bright-line test (see ¶7-050) by providing a collection mechanism where the seller is an offshore person.

The RLWT rules are set out in new subpart RL. Details of the new rules are set out below. All examples are taken from *Tax Information Bulletin* ¶286-104 Vol 28, No 6, July 2016 at 30–56.

Requirements for RLWT to apply

Under s RL 1, for RLWT to apply to a particular disposal, there must be:

- a disposal of residential land located in New Zealand, and
- the residential land purchase amount would be income of the vendor under the bright-line test, ignoring the application of the other land taxing provisions in ss CB 6–CB 12 and the "main home" exclusion, and
- the vendor must be an offshore RLWT person.

Note that vendors who are co-owners will be treated as disposing of separate residential land on the basis of an appropriate split of the underlying residential land and the consideration for its disposal.

RLWT will not apply when the vendor holds an RLWT certificate of exemption that applies for the disposal of the relevant residential land. See discussion below.

▶ ***Note:*** The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill, introduced into Parliament on 8 August 2016, proposes an amendment to ensure that RLWT will not apply to the transfer of residential land as relationship property. Any subsequent disposal of the land may be caught by the RLWT rules. The amendment is intended to apply from 1 July 2016.

Residential land in New Zealand

RLWT will only apply to residential land located in New Zealand. The meaning of "residential land" is the same as for the bright-line test and is discussed at ¶7-050.

Residential land purchase amount

The "residential land purchase amount" is defined as an amount paid or payable for the disposal of residential land located in New Zealand, but excludes deposits and part-payments as long as all deposits and part-payments total in aggregate less than 50% of the purchase price for the land. This rolling aggregate is to ensure that part-payments are not used to circumvent the application of the RLWT.

Example 1:

Elizabeth is an offshore RLWT person. Elizabeth agrees to sell her house to Rebecca for $500,000. The contract requires Rebecca to pay a 10% deposit of $50,000, with the remaining $450,000 to be paid upon settlement. The $50,000 deposit is not a residential land purchase amount, but the $450,000 paid upon settlement is a residential land purchase amount. RLWT is calculated based on the purchase amount of $500,000.

Bright-line income

The next requirement is that the residential land purchase amount would be income for the vendor under the bright-line test, ignoring the application of the other land taxing provisions in ss CB 6–CB 12 and the "main home" exclusion.

The bright-line test does not generally apply when one of the other land taxing provisions in ss CB 6–CB 12 applies. However, RLWT will apply when a vendor disposes of the residential land within the two-year bright-line period, regardless of whether another land taxing provision applies. This ensures difficulties of collection of tax from foreign investors are somewhat alleviated. In addition, because it is unlikely that the property being sold in New Zealand by an offshore RLWT person would be that person's main home, the main home exclusion is not available for the purposes of the RLWT.

Note that this reference to "income" under the bright-line test means that there will not need to be a land title transfer for an RLWT obligation to arise; there will only need to be a residential land purchase amount. This means that off-the-plan sales, for example, will be subject to RLWT if the other conditions are also met.

The bright-line test is discussed in detail at ¶7-050. In essence, the test generally applies where the vendor acquired the property on or after 1 October 2015 and has owned the property for less than two years before disposing of it. Although the main home exclusion does not apply for RLWT, there is an exemption or roll-over relief from RLWT for inherited property and for transfers of relationship property, as provided under the bright-line test.

Offshore RLWT persons

The vendor must be an "offshore RLWT person" for RLWT to apply. "Offshore RLWT person" is defined in s YA 1 and covers both individuals and non-individuals, such as companies or trusts.

An individual is an "offshore RLWT person" if they are:

- a New Zealand citizen who is outside New Zealand and has not been in New Zealand within the last three years
- the holder of a New Zealand residence class visa granted under the Immigration Act 2009 and is outside New Zealand and has not been in New Zealand within the last 12 months, or
- not a New Zealand citizen and does not hold a New Zealand residence class visa granted under the Immigration Act.

Example 2:

Mary is an investor in residential property. She sells a piece of residential land located in Auckland to Jim. Mary is in New Zealand at the time of the sale, but she is not a New Zealand citizen and does not hold a residence class visa granted under the Immigration Act. Mary is an "offshore RLWT person".

Example 3:

Tane is a New Zealand citizen and is relocated overseas with his job. Eighteen months after moving overseas, he sells his residential property. Tane has not been back in New Zealand since relocating. Tane is not an offshore RLWT person at the time of the sale.

The definition of an individual "offshore RLWT person" is the same as that for an individual "offshore person" under the Tax Administration Act 1994 (see ¶7-018). However, in the case of non-individuals, the definitions are different.

A person is considered to be an "offshore RLWT person" if any of the following conditions are met:

- the person is incorporated outside New Zealand
- the person is not a natural person and is registered outside New Zealand
- the person is constituted under foreign law

- the person is a company or a partner in a limited partnership and more than 25% of the company's directors or of the limited partnership's general partners are offshore RLWT persons
- the person is a company and more than 25% of the company's shareholder decision-making rights are held directly or indirectly by offshore RLWT persons, or
- the person is a partner in a limited partnership or an owner of an effective look-through interest in a look-through company (LTC), and more than 25% of the partnership's partnership shares or of the LTC's effective look-through interests are held directly or indirectly by offshore RLWT persons.

▶ ***Note:*** An amendment is proposed in the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill to clarify that the definition applies at the limited partnership level (rather than the partner level, which is the case for ordinary partnerships) and at the company level for look-through companies.

A trust is considered an "offshore RLWT person" if any of the following are met:

- more than 25% of the trustees are offshore RLWT persons
- more than 25% of the people that have the power to appoint or remove a trustee of the trust, or to amend the trust deed, are offshore RLWT persons
- all natural person beneficiaries and all natural person discretionary beneficiaries of the trust are offshore RLWT persons
- all beneficiaries and discretionary beneficiaries of the trust are offshore RLWT persons
- a beneficiary, including a discretionary beneficiary, that is an offshore RLWT person has received a distribution from the trust in one of the last four years before the relevant disposal of residential land and, if the beneficiary is a natural person, the total distributions to the beneficiary for the relevant year are more than $5,000, or
- the trust has disposed of residential land within four years before the relevant disposal of residential land and the trust has a beneficiary, including a discretionary beneficiary, that is an offshore RLWT person.

The definition of "offshore RLWT person" for a trust is intended to ensure that gains do not escape tax through manipulation of the trust. It is not intended that it would normally apply to properties held in ordinary family trusts where some of the natural person beneficiaries may be New Zealand citizens but now reside overseas.

Example 4:

Debbie and Greg are the settlors and trustees of a family trust. They are both New Zealand citizens and live in New Zealand. Dan and Natalie are discretionary beneficiaries of the trust and are also New Zealand citizens. Dan lives in New Zealand, but Natalie has lived in Australia for the past five years and has not been back to New Zealand.

The trust property consists of the family home in New Zealand as well as some shares and money held in a savings account. Each year, Dan and Natalie receive around $1,000 each in distributions from the trust.

Debbie and Greg as trustees of the trust are not offshore RLWT persons, because they themselves are not offshore RLWT persons and, of the two beneficiaries, only Natalie is an offshore RLWT person, but she has not received more than $5,000 in distributions from the trust in any of the previous four years.

Example 5:

Matilda and Madeline are natural persons who are also offshore RLWT persons. They are the only natural person beneficiaries of a trust. A New Zealand charity is appointed as a discretionary beneficiary of the trust. The settlor and trustees of the trust are not offshore RLWT persons. The trustees are treated as offshore RLWT persons, because all natural person beneficiaries of the trust (Matilda and Madeline) are offshore RLWT persons.

A corporate trustee will be able to qualify for the non-offshore exemption if it meets both the company and trust criteria above.

Other shareholders (non-controlling shareholders)

Non-controlling shareholders are shareholders with less than a 50% voting interest or market value interest in the company. A non-controlling shareholder's liability will be incurred when, at the time the arrangement is entered into, it could reasonably be concluded, having regard to the materiality of the benefit derived by the shareholder, that he or she was a party to it. The extent of a non-controlling shareholder's liability is determined in the same way as a controlling shareholder's liability.

¶16-890 Reassessment of a company following liquidation

[IT07 s HD 15(6), (7); C93 s 330(2)]

Any time after a company has been liquidated, the Commissioner may issue or amend an assessment for any tax liability of the company, as if the company had not been liquidated. The Commissioner's ability to issue the reassessment is not precluded by any prior approval he may have given to removal of the company from the register of members. See *BNZ Finance Ltd v Holland* (1997) 18 NZTC 13,461 (PC).

Following the assessment, the Commissioner is required to nominate one or more persons considered to be liable for the tax payable under the assessment. The persons nominated become liable for the tax owing under the assessment, subject to the possibility of a successful challenge to the assessment.

A company that is liquidated and removed from the register of companies cannot be the subject of a valid assessment. There is no ability for the former company as a now non-existent person to respond to the assessment by issue of a notice of proposed adjustment within the prescribed statutory period. That conclusion is not altered should the company subsequently be restored to the register. Because it is a nullity, the Commissioner cannot rely on the so-called assessment as being deemed to be correct, so as to enable recovery of the company's unpaid tax from the shareholders. See *Spencer v C of IR* (2004) 21 NZTC 18,818. Section 330(2) of the Companies Act 1993 provides that a company restored to the register is treated as if it had never been removed. In *C of IR v Registrar of Companies* (2007) 23 NZTC 21,215 proceedings brought by the Commissioner against an unregistered company were treated as validated.

Chapter 17 IMPUTATION

¶17-010 Introduction to the imputation regime

[IT07 subparts LE, OB, ss IA 2(4)(b), LA 5(4), LE 1(1), LE 2, LE 3]

The imputation system commenced on 1 April 1988 with the objective of eliminating double taxation on company profits. Prior to the introduction of the imputation system, companies would be required to pay tax on their profits, and then shareholders would be required to pay tax on those profits when they were distributed. Under the imputation system, a company effectively attaches income tax credits (known as "imputation credits") to cash and non-cash dividends and taxable bonus issues distributed to shareholders. The shareholders then use those imputation credits to reduce their own tax liability in respect of the company's dividends. The shareholder includes both the dividends and the imputation credits as assessable income, with a credit being allowed against the shareholder's income tax liability for an amount equal to the attached imputation credits.

An individual on a marginal tax rate that is less than the company tax rate receives surplus imputation credits to offset against his or her income tax liability for the year. Any individual's unused surplus imputation credits may be carried forward as a credit of tax to the next income year. The amount carried forward is reduced firstly by any amount extinguished when outstanding tax is written off (see ¶2-119), and secondly by any tax liability for the next income year. (For certain other types of taxpayers (eg companies, trustees and Maori authorities) surplus credits may be carried forward as a tax loss and offset against net income of succeeding income years.) See ss LE 2, LE 3, and ¶2-110. An individual taxpayer on a marginal tax rate that is higher than the company tax rate will receive insufficient imputation credits to fully cover his or her tax liability in respect of the dividend and will be liable to pay additional tax.

Example:

Widgets Ltd has taxable income of $100 for the 20X2/X3 income year, and has resolved to pay from its after tax income a fully imputed dividend to its only shareholder, William:

	$
Taxable income	100.00
Tax @ 28%	28.00
After tax income	72.00
Dividend	72.00
Imputation credits	28.00
Gross dividend paid to shareholder	100.00

William's final tax liability in respect of the fully imputed dividend paid by Widgets Ltd will be as follows:

(a) Assume William has an effective tax rate of 30%.

	$
Dividend income	72.00
Imputation credits attached	28.00
Gross dividend income	100.00
Tax @ 30%	30.00
Less: imputation credits	(28.00)
Tax to pay	2.00

(b) Assume William has an effective tax rate of 17.5%.

	$
Gross dividend income	100.00
Tax @ 17.5%	17.50
Less: imputation credits	(28.00)
Surplus imputation credits to carry forward	10.50
Tax to pay	0.00

(c) Assume William has an effective tax rate of 33%.

	$
Gross dividend income	100.00
Tax @ 33%	33.00
Less: imputation credits	(28.00)
Tax to pay	5.00

Every resident company is required to maintain an imputation credit account to track their imputation credits on an annual basis. An imputation credit account is a memorandum account only. Tax payments made by a company are credited to its account, and as those tax payments are passed on to shareholders, the account is debited. See ¶17-025. Companies are restricted by the allocation rules from attaching too many imputation credits to dividends. The number of imputation credits attached to a dividend must not exceed the maximum imputation ratio. See ¶17-060.

For the imputation rules relating to qualifying companies see ¶19-010, ¶19-115 and ¶19-120.

¶17-012 Recent proposals relating to the imputation regime

On 15 September 2015, the government released an issues paper, "Loss grouping and imputation credits". The paper considers an issue with the interaction between the loss grouping rules and the imputation rules.

Less income tax is paid when a profit company and a loss company engage in loss grouping, which results in the profit company receiving fewer imputation credits than it would have, had it not engaged in loss grouping. Having fewer imputation credits becomes an issue when that profit company later chooses to pay a dividend to its shareholders. Unless the profit company is wholly-owned by a corporate parent, the dividend will be taxable, and the imputation credits in the profit company's imputation credit account will determine whether it is able to fully impute that dividend. In some cases, the profit company will have insufficient

imputation credits to enable it to pay a fully imputed dividend. This results in a tax impost for the shareholder upon distribution of the loss-sheltered profits, effectively clawing back the benefit of the loss grouping.

The issues paper discusses whether this inability for non-wholly-owned companies to fully impute dividends as a result of loss grouping is appropriate and concludes it is not. The paper suggests that companies engaging in a loss offset should, by mutual agreement, be allowed to perform an imputation credit transfer. The imputation credit transfer would involve, as part of a loss grouping arrangement, the loss company debiting its imputation credit account and the profit company crediting its imputation credit account by the same amount. It is proposed that the respective debit and credit to the imputation credit accounts would occur at the same time as the payment of the dividend by the profit company to facilitate the full imputation of that dividend.

▶ ***Note:*** Legislation to implement these proposals was included in the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Bill, introduced into Parliament on 3 May 2016 and reported back from the Finance and Expenditure Committee on 24 November 2016. The proposed amendments will allow companies that are commonly owned, but not wholly owned, to transfer imputation credits as part of loss grouping. Imputation credits will be transferred to the company that receives the benefit of the loss grouping (the profit company) and be sourced from either the company that provides the benefit of the loss grouping (the loss company) or another company in the group that will receive the benefit of a dividend paid by the profit company (the imputation source company). Groups will elect to transfer credits equal to the tax effect of the total of loss grouping to a company within the commonly owned group that is in a profit position and the transfer will occur when, within four years, the profit company pays an imputed dividend to its shareholders.

The amendments are intended to come into force on 1 October 2016 and apply for the 2017/18 and later income years.

¶17-015 Legislation for the imputation regime [IT07 Pt O]

The imputation and related memorandum account provisions are located in Pt O of the Income Tax Act 2007, consisting of the following subparts:

- Subpart OB — Imputation Credit Accounts (ICAs) (which deals with income tax paid by a New Zealand company that may be credited to shareholders).
- Subpart OC — Foreign Dividend Payment Accounts (FDPAs) (which deals with foreign dividend payments (FDP) made to the Commissioner on account of foreign dividends). See below regarding phase-out.
- Subpart OF — Available Subscribed Capital Accounts (ASCAs) (which deals with available subscribed capital lost on redemption of units by unit holders in a group investment fund deriving category A income or in a qualifying unit trust). See ¶24-070.
- Subpart OK — Maori Authority Credit Accounts (MACAs) (which deals with income tax paid by a Maori authority that may be credited to a member of the authority). See ¶24-314.
- Subpart OP — which deals with the various memorandum accounts of consolidated groups. See ¶17-250 and ¶20-070.

This chapter focuses principally on imputation. For discussion on the other memorandum accounts, see the paragraphs noted above.

The Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009 repealed subpart RG, thereby removing the liability for resident companies to pay FDPs on dividends they receive after 30 June 2009. For all income years beginning on or after 1 July 2009 no new FDP credits are generated and consequently certain sections of the Income Tax Act 2007 relating to credits and debits for FDP have been repealed. When the 2009 reforms were enacted, it was necessary to provide for FDP companies with credit balances in their

FDP accounts and other memorandum accounts. A policy of gradually phasing out FDP accounts was to be adopted. Under the phase-out plan, FDP companies would have five years within which to distribute existing FDP account credit balances, after which any remaining credit balances would be converted into imputation credits, which are non-refundable. Note, however, that this plan was not enacted as part of the 2009 reforms and it was stated at the time that it would be part of a separate taxation Bill. This was never done, but on 3 May 2016, provisions to repeal all references to FDP credits and FDP accounts were introduced into Parliament as part of the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Bill.

¶17-020 Summary of principal features of imputation regime

The principal features of the imputation system are as follows:

- New Zealand resident companies must maintain an imputation credit account (ICA). See ¶17-025.
- The tax year for imputation purposes is always 1 April to 31 March, irrespective of the company's balance date.
- Credits to the ICA include New Zealand provisional and terminal tax paid for the 1989 and later years and imputation credits on dividends received. See ¶17-040.
- Debits to the ICA include imputation credits attached to dividends paid and tax refunds. See ¶17-045.
- A New Zealand resident company can allocate tax credits to dividends paid to its shareholders by drawing from the pool of credits in the ICA.
- The first dividend in the tax year ordinarily sets the benchmark level for credit allocations in that year unless the statutory declaration procedures have been exercised (non-compliance incurs penalties). See ¶17-070.
- A company making a dividend payment is not obliged to allocate a credit (however, should the company do so, 28:72 from the 2011/12 income year of the "net" dividend is the maximum ratio that may be allocated). See ¶17-060.
- If an over-allocation of credits leaves the ICA in debit at 31 March for any year, the company must pay to Inland Revenue the amount of the shortfall plus 10%. See ¶17-100.
- Special anti-streaming rules apply to prevent the direction of credits to some shareholders and not others. See ¶17-120.
- Any change in shareholding or in shareholders' interests of over 34% could bring about the cancellation of credits in the ICA. See ¶17-055.
- All ICA companies must file an annual imputation return, a company dividend statement and a shareholder dividend statement. See ¶17-080–¶17-090.
- The imputation regime is linked to the consolidation rules.
- There is no provision for the grouping of imputation credits by companies in the same group (except where the company is a consolidated group: see ¶20-070) — imputation credits may be transferred only by the payment of a dividend (accordingly, companies included in the same group may pass on imputation credits only by the actual payment of an intercorporate dividend and allocate tax credits under the normal rules for imputation).
- An individual's tax liability is reduced by any imputation credits (with any excess credits carried forward to the next income year: see ¶2-110).
- Special rules prevent unit trust managers and trustees and managers of group investment funds that derive category A income from using imputation attached to dividends received upon the redemption of units where the dividend merely reflects the cost to those persons of purchasing the units.

- Non-residents are subject to non-resident withholding tax (NRWT) only if they hold a less than 10% voting interest in the company or the rate of NRWT applicable to the dividend is 15% or more. The monetary effect of the NRWT liability may be negated under the foreign investor tax credit (FITC) regime: see ¶26-500.
- A company has the option of declaring bonus issues (taxable or non-taxable). Taxable bonus issues may convey imputation to shareholders (non-taxable bonus issues, however, are not taxed in the shareholder's hands and therefore do not carry any credits). See ¶16-570 and ¶16-685.
- A producer board, because it does not have a normal company shareholding structure, is treated as a company for tax purposes to enable the board to pass on credits to its members. See ¶24-150.
- Primary sector producer and marketing co-operatives which are incorporated as companies may allocate imputation credits to dividends paid. See ¶24-160.
- An Australian-resident company may elect to maintain an ICA. See ¶17-210.
- Certain companies may form an imputation group. See ¶17-240–¶17-250.
- Special rules apply where overpaid tax is applied to other tax liabilities. See ¶17-040 and ¶17-045.

IMPUTATION CREDIT ACCOUNT

¶17-025 Companies required to maintain an imputation credit account (ICA)

[IT07 ss OA 2(2), (3), OB 1]

Under the imputation system a company may allocate or "impute" the tax it pays on its income to its shareholders on the dividends it pays. The gross dividends are included as income of the shareholders, but their individual tax liabilities are satisfied in part by the amount of any tax credit so allocated to the dividends.

An ICA is a memorandum account (outside the books of account and not relating to income or expenditure) which records a company's tax payments and the allocation to shareholders of the benefit of those accounts. Consequently, every New Zealand resident company is required to maintain an imputation credit account (ICA) because the balance in the ICA determines the amount of credits the company may allocate to its shareholders (ie to its dividend payments) and the ICA keeps a record of the tax credits which are available for allocation to dividend payments.

The New Zealand imputation system was extended to Australian-resident companies from 1 April 2003. See ¶17-200–¶17-250.

¶17-030 Companies not permitted to maintain an imputation credit account (ICA)

[IT07 s OB 1(2)]

Certain companies are not permitted to maintain an imputation credit account (ICA). These companies are as follows:

- A company acting only in the capacity of trustee. When a company acts as a trustee, the trustee/beneficiary rules apply. However, there is an exception to this in that a company that is a group investment fund deriving category A income must operate an ICA. Companies that act partly in the capacity of trustees and partly in other activities allocate debits and credits to the ICA only in respect of their non-trustee activities.
- A company whose constitution prohibits anything from being distributed to any shareholder (or member). This would include an incorporated club or society.
- A company that derives only exempt income. This does not include a company that solely derives dividend income exempt from tax (see ¶16-800), in which case it must operate an ICA.
- A company that is a New Zealand resident and is treated as a non-resident by virtue of a double tax agreement.

- A Maori authority. See ¶24-288. A Maori authority is required to maintain a Maori Authority credit account.
- A local authority.
- A Crown Research Institute.
- A subsidiary company of the Accident Compensation Corporation to which s 334(1) of the Accident Insurance Act 1998 or s 266 of the Accident Compensation Act 2001 applies.
- A multi-rate PIE. See ¶29-100.

By virtue of s OB 1(1), non-resident companies are also not able to establish an ICA. When a company is non-resident for all or part of a year, it may not operate an account for the period in which it is a non-resident. When a company ceases to be resident in New Zealand, it must debit its ICA by the amount of the credit balance of the ICA immediately before the date of change of residency. See *Tax Information Bulletin* ¶610-107 Vol 6, No 10, March 1995 at 7.

A company that is resident in New Zealand and Australia may choose to be an Australian ICA company and elect to maintain an ICA for the purposes of the trans-Tasman imputation system. See further at ¶17-200 and ¶17-210.

¶17-035 Information to record for imputation purposes

[IT07 ss OA 3, OA 7; TAA s 22(2)(k)]

Imputation is recorded over a tax year from 1 April to 31 March, irrespective of the company's own balance date. Every company must record as its opening balance on 1 April in each year the amount of the closing balance as at the previous 31 March.

An imputation credit account (ICA) balance at any time is the difference between the aggregate credits and debits to the account at that time. See s OA 3.

The amount is a credit arising in the imputation credit account (ICA) when the closing balance is the excess of credits over debits and a debit when the closing balance is the excess of debits over credits. If the credits allocated to shareholders during the year exceed the credits to the company's ICA when it is balanced on 31 March, further income and penalty taxes are payable. See s OA 3(3), (4).

For the tax year when the company first becomes an ICA company, the opening balance of the ICA is nil. See s OA 7.

Records relating to credit and debit entries in the ICA during a tax year must be retained for seven years after the end of the tax year. See s 22 of the Tax Administration Act 1994.

¶17-040 Credits to record in imputation credit account (ICA)

[IT07 ss OA 5, OA 7, OB 4–OB 29, Table O1, YA 2(7)]

An imputation credit account (ICA) company has an imputation credit for an amount of income tax or provisional tax paid. Credits that arise are set out in Table O1 and must be read in conjunction with the relevant section when identifying ICA credits. Only one credit entry is allowed for each tax payment type made. See OB 4(5).

These credits increase the amount available for allocation to dividends paid to shareholders, while credits allocated to those dividends are debited to the ICA.

For ease of reference the transactions that give rise to imputation credits in an ICA are discussed below and numbered in accordance with the numbering used in Table O1 of the Income Tax Act 2007.

Timing of credits

The timing of when the credit arises is set out in Table O1: imputation credits (see below) and in each relevant section. Generally an imputation credit arises on the day the amount of tax is paid, transferred or withheld.

▶ ***Note:*** Table O1 is located immediately after s OB 82.

Table O1: imputation credits

Row	Imputation credit	Credit date	Further defined
1	Opening credit balance: *the opening balance is a credit balance for a tax year if at the end of the previous year the closing balance was a credit.*	1 April	s OA 7
2	Provisional tax and income tax paid.	day of payment	s OB 4
3	Deposit into tax pooling account: *any tax payment made by an intermediary into a tax pooling account. See ¶22-365.*	day of payment	s OB 5
4	Transfer from tax pooling account: *any transfer of tax by an intermediary to company of an entitlement to funds that are held in a tax pooling account.*	day of credit	s OB 6
5	Payment of further income tax: *an ICA company has an imputation credit for an amount of further income tax paid under s OB 65 or s OB 66.*	day of payment	s OB 7
5B	Payment of qualifying company election tax: *any qualifying company election tax paid by the company.*	day of payment	s OB 7B
5C	Tax credit for research and development expenditure: *for the 2008/09 income year, the amount of any research and development tax credit under s LH 2.*	day return filed	s OB 7C
6	Amount of tax withheld for resident passive income: *the amount of any RWT deduction treated as having been derived by the company in terms of s RA 9(1)(b).*	day on which amount is withheld	s OB 8
7	Imputation credit attached to dividend derived: *imputation credits attached to dividends received by a company during the tax year.*	day on which dividend is paid	s OB 9
7B	Attributed PIE income with imputation credit: *an ICA company that is an investor in a multi-rate PIE has an imputation credit for the amount of an imputation credit allocated to it under s HM 54.*	day of attribution	s OB 9B
8	FDP credit attached to dividend derived when not FDPA company: *foreign dividend payment credits attached to dividends received by a company with no foreign dividend payment account.*	day on which dividend is paid	s OB 10
9	*[Repealed]*		
10	Transfer from FDP account: *credits transferred from the FDPA.*	day of transfer	s OB 12

Table O1: imputation credits

Row	Imputation credit	Credit date	Further defined
11	Transfer of debit balance when company leaves wholly-owned group: *the credit arising in the ICA of a company that ceases to be a member of a wholly-owned group.*	day on which company leaves group	s OB 13
12	Additional income tax payable when company leaves wholly-owned group: *the additional income tax paid by a company that ceases to be a member of a wholly-owned group under s OB 71.*	day of payment	s OB 14
13	Additional income tax when company joins wholly-owned group: *the additional income paid by a company that joins a wholly-owned group under s OB 72.*	day of payment	s OB 15
14	Attribution for personal services if company is not qualifying company: *under the personal attribution rules (38.89% from 1 April 2011) of an amount attributed under s GB 29. See s OB 16(1) and ¶33-325.*	31 March	s OB 16
15	*[Repealed]*		
16	Transfer from ASC account: *the amount of a credit balance transferred from an available subscribed capital account (ASCA) calculated under s OF 5(4). See ¶24-070 and ¶24-192.*	day of transfer	s OB 18
17	Transfer to master fund by company: *an amount equal to the tax percentage of the amount of expenditure transferred to a master fund (a public unit trust or group investment fund that derives category A income) under ss DV 5–DV 7.*	day of transfer	s OB 19
18	Maori authority credit attached to distribution: *Maori authority credits attached to a distribution made to the company during the tax year.*	day of distribution	s OB 20
19	Transfer of balance of Maori authority credit account: *in the case of a company that stops maintaining a Maori authority credit, the amount of the credit balance in the Maori authority credit account on the date the account is closed. See ¶24-327.*	day of transfer	s OB 21
20	Replacement payment paid under share-lending arrangement: *imputation credits being attached, or treated as being attached, to a replacement payment paid to the company under a share-lending arrangement during the tax year under s OB 64 or RE 25.*	day of payment	s OB 22
21	Imputation credit shown in credit transfer notice: *imputation credits shown in a credit transfer notice issued by the company during the tax year.*	day on which notice is given	s OB 23

Table O1: imputation credits

Row	Imputation credit	Credit date	Further defined
22	Imputation credit, FDP credit, or policyholder credit on resident's restricted amalgamation: *an ICA company has an imputation credit for the amount of credit that arises on or after a resident's restricted amalgamation. The credit arises in the amalgamated company's ICA when ss OA 10–OA 17 apply.*	credit date in account of amalgamating company	s OB 24
23	Reversal of debit for tax advantage arrangement: *an amount to offset a debit for imputation credits determined to have been the subject of an arrangement to obtain a tax advantage to the extent that it is subsequently established that the imputation credits were not the subject of any such arrangement.*	debit date of debit	s OB 25
24	Eliminating debit for loss of shareholder continuity cancelling tax pooling account deposit that is refunded or credited: *credit arises to eliminate what would otherwise be a double debit when there is a shareholder continuity debit under s OB 41 and after the shareholder continuity debit, a further debit arises under s OB 34 for a refund of an amount by an intermediary from a tax pooling account.*	day of refund or credit	s OB 26
25	Amount of tax withheld by Australian ICA company for non-resident passive income: *an Australian ICA company has an imputation credit for an amount of tax withheld by the payer of non-resident passive income.*	day on which amount is withheld	s OB 27
26	Amount of tax withheld from schedular payment to Australian ICA company: *an Australian ICA company has an imputation credit for an amount equal to the amount of tax for a schedular payment paid to the company as a non-resident contractor.*	day on which amount is withheld	s OB 28
27	Schedular income tax paid by Australian ICA company: *an Australian ICA company has an imputation credit for a payment of income tax relating to the company's schedular income tax liability for income derived under ss CR 3, CV 16 and CV 17 (non-resident insurers, shippers and film renters, respectively).*	day of payment	s OB 29

Provisional tax

Any reference to income tax paid by a taxpayer in the imputation legislation is deemed to include a reference to provisional tax paid by the taxpayer. This means that a credit to the ICA arises for payments of instalments of provisional tax. An imputation credit also arises for a company on the transfer of overpaid provisional tax by one company within a wholly-owned group of companies to another company in the same group on the date the transfer is notified to the Commissioner.

For additional credits arising in an ICA for an Australian ICA company, see ¶17-215.

¶17-045 Debits to record in imputation credit account (ICA)

[IT07 ss OA 7, OB 30–OB 59, Table O2]

Debits to the imputation credit account (ICA) result in a reduction in the tax credits available for distribution to shareholders.

Timing of debits

For ease of reference the transactions that give rise to imputation debits in an ICA are discussed below and numbered in accordance with the numbering used in Table O2 of the Income Tax Act 2007. The following are debits to an ICA during a tax year:

▶ ***Note:*** Table O2 is located immediately after s OB 82.

Table O2: imputation debits

Row	Imputation debit	Debit date	Further defined
1	Opening debit balance: *the opening balance is a debit balance for a tax year if at the end of the previous tax year the closing balance was a debit. The debit date is 1 April irrespective of the company's balance date.*	1 April	s OA 7
2	Imputation credit attached to dividend paid by a company: *debit date is the day the dividend is paid. In some cases, the debit may not arise in the ICA of the company that actually paid the dividend, ie when the relevant dividend is paid under a staple stock arrangement within the scope of s GB 37. See ¶17-115.*	day of payment	s OB 30
3	Allocation of provisional tax: *provisional tax allocated by a company to an underpaid company in terms of s RC 32 (payments to be set off within wholly-owned group).*	day of notice of allocation	s OB 31
4	Refund of income tax: *a debit arises for income tax refunded to the company except in circumstances set out in s OB 32.*	day of refund	s OB 32
5	Overpaid income tax applied to meet another tax liability: *any overpaid income tax applied by the Commissioner in satisfaction of tax liabilities other than income tax or provisional tax instalments. (An exception to this rule applies where a debit has already arisen owing to a breach in continuity of shareholding.)*	day of application	s OB 33
6	Refund from tax pooling account: *refunds from an intermediary from a tax pooling account, for which a credit has been recorded in the company's ICA. See ¶17-040.*	day of refund	s OB 34
7	Transfer of entitlement to another person in tax pooling account: *a transfer from the company to another taxpayer by an intermediary of funds in a tax pooling account, for which a credit has been recorded in the company's ICA. See ¶17-040.*	set out in s OB 35	s OB 35

Table O2: imputation debits

Row	Imputation debit	Debit date	Further defined
7B	Debit for transfer from tax pooling account for policyholder base liability: *an amount transferred from a tax pooling account to a tax account with the Commissioner, to the extent to which the company is a life insurer, and the amount satisfies its schedular income tax liability for schedular policyholder base income or its income tax liability for a life fund PIE that is a multi-rate PIE.*	31 March	s OB 35B
8	Refund of FDP when not FDPA company: *refunds of foreign dividend payments (FDP) when a company is not a FDPA company.*	day of refund	s OB 36
9	Transfer, refund or use of tax credit: *the amount transferred under s LA 6(2)(d) (remaining refundable credits: PAYE, RWT and certain other items), the amount of any credit of tax refunded to the company under s LA 6(2)(e).*	day of transfer, refund or use	s OB 37
10	Overpaid FDP applied to satisfy liability when not FDPA company: *the amount of any overpaid FDP that the Commissioner applies at a time when the company is not an FDPA company, in satisfaction of an amount due, other than an income tax liability, a provisional tax liability or relating to a foreign dividend.*	day of application	s OB 38
11	Overpaid income tax or FDP applied to satisfy pre-imputation income tax when not FDPA company: *the amount of any overpaid income tax or FDP that the Commissioner applies at a time when the company is not an FDPA company in satisfaction of income tax that was due and payable before the imputation rules came into force (unless the company previously experienced a breach in shareholder continuity).*	day of application	s OZ 3
12	*[Repealed]*		
13	Attribution for personal services: *an amount equivalent to the credit entry made for 38.89% of the amount attributed under the personal attribution rules, if the company's financial statements are adjusted to reflect this. See s OB 16.*	31 March	s OB 40
14	Debit for loss of shareholder continuity: *credits that fail to meet the continuity of shareholding requirements. See s OB 41 and ¶17-055.*	time of loss of continuity	s OB 41
15	Debit for on-market cancellation: *a company repurchasing shares on-market with no available subscribed capital remaining.*	day of acquisition	s OB 42
16	Debit for breach of imputation ratio: *a deficit resulting from the allocation of credits to shareholders which differ from the benchmark dividend imputation ratio.*	31 March	s OB 43

Table O2: imputation debits

Row	Imputation debit	Debit date	Further defined
17	Transfer for debit balance when company leaves wholly-owned group: *a company that leaves a wholly-owned group and elects under s OB 13 to debit the ICA of another group company with the debit balance in the leaving company's ICA.*	day on which company leaves group	s OB 44
18	Redemption debit for unit trust or group investment fund for income year: *a debit arises where the manager or trustee of a unit trust or GIF derives a dividend on redeeming units purchased from investors in the ordinary course of its activities. The amount of the debit is the greater of:* ■ *the total imputation and FDP credits attached to the dividend, or* ■ *the amount of income tax liability that is attributable to the dividend.* *See Tax Information Bulletin ¶79-101 Vol 7, No 9, February 1996.*	day on which return of income for income year is filed	s OB 45
19	Transfer from member fund to master fund: *a debit arises where a member fund transfers an amount of expenditure to a master fund under ss DV 5–DV 7. The amount of the debit is the amount of expenditure transferred multiplied by the company tax rate.*	31 March	s OB 46
20	Debit for policyholder base imputation credits: *a life insurer who elects to transfer any of the credit balance in the company's ICA to its policyholder base.*	31 March	s OB 47
20B	Recipient of R&D loss tax credits	31 March	s OB 47B
21	Credit balance when Maori authority credit account starts: *the amount of any credit in the imputation account of a company that becomes a Maori authority and establishes a Maori authority credit account.*	day of becoming Maori authority	s OB 48
22	Credit attached to replacement payment paid by company under share-lending arrangement: *imputation credits attached under s OB 64 to a replacement payment paid under a share-lending arrangement by the company during the tax year.*	day of payment	s OB 49
23	Credit attached to dividend paid to company shown in returning share transfer: *imputation credits attached to a dividend paid to the company during the tax year as a share user (or an associate of a share user) in a returning share transfer that is not a share-lending arrangement.*	day of payment	s OB 50
24	Credit attached to dividend paid to company shown in credit transfer notice: *imputation credits attached to a dividend paid to the company in a tax year and which are shown in a credit transfer notice issued by the company.*	day of payment	s OB 51

Table O2: imputation debits

Row	Imputation debit	Debit date	Further defined
25	Credit that is also credit to imputation credit account of consolidated imputation group	credit date for imputation credit	s OB 52
26	Imputation debit, FDP debit, or policyholder debit in account of amalgamating company	debit date in account of amalgamating company	s OB 53
27	Debit for tax advantage arrangement: *penalty debits when tax credits are allocated in pursuance of an avoidance arrangement in terms of s GB 36.*	last day of tax year in which arrangement began	s OB 54
28	Retrospective attachment of imputation credit to non-cash dividend	day of payment of dividend	s OB 55
29	Final balance when ICA company status ends: *an amount equivalent to the credit balance in the ICA when a company ceases to operate an ICA.*	day of cessation	s OB 56
30	Refund of amount of tax for non-resident passive income to Australian ICA company: *see ¶17-215.*	day of refund	s OB 57
31	Refund of amount of tax for schedular payment to Australian ICA company: *see ¶17-215.*	day of refund	s OB 58
32	Refund of schedular income tax to Australian ICA company: *see ¶17-215.*	day of refund	s OB 59

¶17-050 Imputation credit account (ICA): debit or credit incorrectly recorded

[IT07 s OA 2(5); TAA s 104B]

Should the Commissioner consider that there has been an incorrect recording of debits and credits arising in the company's imputation credit account, the Commissioner may issue a determination under s 104B of the Tax Administration Act 1994 adjusting the amount of a credit or debit or a credit/debit date. Any such determination under this section may be challenged in the same way as an assessment.

¶17-055 Continuity requirements for carry forward of imputation credits

[IT07 ss GB 34, OA 8, OB 41]

A company cannot carry forward imputation credits unless a continuity of shareholding test is satisfied (see ¶18-023). This test limits the carry-forward of imputation credits for subsequent utilisation to situations where at least 66% of those persons who will benefit from such utilisation bore the tax liability that gave rise to the credit. In other words, imputation credits cannot be retained by a company that is later sold to shareholders who can make effective use of the imputation credits. To prevent this, credits in the company's imputation credit account (ICA) at the time of the shareholding change are cancelled by a debit entry in the ICA. See ss OA 8(6)(a) and OB 41. Such an entry will be treated as arising on the date the shareholder continuity is breached.

Shareholder continuity requirements

For the purposes of the continuity of shareholding requirements for imputation, the minimum voting interest or market value interest of any person will be equal to the lowest voting interest or market value interests held by that person during the period. See s OA 8(7). When calculating a person's voting or market value interests for imputation purposes, redeemable preference shares are taken into account.

Example:

AB Ltd wholly-owns XY Ltd as a foreign company and the year's financial profile of the group comprises:

- $1m of net interest deductions for AB Ltd
- $3m of net interest deductions for the whole group
- $3m adjusted net profit for AB Ltd
- $12m adjusted net profit for the worldwide group.

The formula values are:

- net interest: $1m
- NZ group ratio: 0.333 ($1m ÷ $3m)
- threshold ratio: 0.275 (1.1 × $3m ÷ $12m).

The formula becomes:

$$\$1{,}000{,}000 \times \frac{0.333 - 0.275}{0.333} = \$174{,}174$$

The $174,174 is income for AB Ltd so that the company's net interest deduction is $825,826.

Chapter 27 FARMING, FISHING AND AQUACULTURE

FARMING

¶27-010 Income from farming [IT07 s CB 1]

Income from carrying on a farming or agricultural business is to be included as part of the assessable income of a taxpayer.

Whether an activity is a farming or agricultural business depends on whether the activity or enterprise constitutes a business for tax purposes and whether the business is carried on for farming or agricultural purposes. When a business is a business for tax purposes, there must be an intention by the person to make a profit or a reasonable prospect that the person will make a profit. See ¶5-172 and ¶5-175.

Farming or agricultural business

Inland Revenue accepts that soil cultivation, cropping or animal husbandry, growing plants, shrubs or flowers, growing fruit or grapes, beekeeping, poultry farming, sharemilking and running an orchard are activities carried on for farming or agricultural purposes. See *Tax Information Bulletin* ¶613-116 Vol 6, No 13, May 1995 at 15–16.

Income

In addition to the net profit derived from a farming business, the income of a farmer includes:

- the market value of meat and produce taken by a sole trader or a partner in a partnership from the farm for private or domestic purposes (see ''Question we've been asked'' QB 14/01: ''Income tax — adjustments for trading stock (including raw materials) taken for own use or consumption'' (published in *Tax Information Bulletin* ¶263-106 Vol 26, No 3, April 2014 at 73))
- grazing fees
- stud fees

- compensation for condemned livestock and hail damage
- payments received for non-compliance with covenant to repair
- insurance proceeds on account of stock or crop losses
- proceeds from the sale of minerals and timber
- income equalisation deposit refunds plus interest
- livestock and unsold wool or other produce on hand at balance date
- prize money won at agricultural shows
- income from the provision of farm holidays or other tourist accommodation
- depreciation recovered on the sale of farming assets, and
- other income (interest, dividends, etc).

¶27-011 Sale and purchase of farm and assets

There are a number of tax consequences to consider when a farm is purchased or sold. When acquiring or selling a farm it is preferable that values are assigned to the assets in the sale and purchase agreement to forestall any possible disputes on individual values for taxation purposes.

Standing timber

A sale and purchase agreement should include the value of any standing timber. Proceeds from the sale of standing timber (including the sale of land with standing timber) are included as income by the vendor. The year in which a deduction for standing timber may be allocated is determined in accordance with s DP 11. See ¶28-014 and ¶28-024.

Buildings

A separate value should be assigned to each building on the farm. Although most buildings now have a 0% annual depreciation rate, it is still depreciable property such that a disposal may give rise to depreciation recovery income. See ¶13-410. Any depreciation recovered on the sale of buildings is taxable to the vendor.

Consumables

Consumables include, among other things, materials such as fencing materials, ear tags, drenches and fertilisers (for fertilisers see ¶27-015). Although the sale of consumable aids creates income for the vendor and a deduction for the purchaser, the deduction available under the general permission is reduced by any unexpired expenditure at the end of the income year. See further at ¶9-011.

Farm development expenditure

The benefit of unamortised farm development expenditure can usually be passed on to the future owner. See ¶27-175. A purchaser might wish to ensure that these values are included as a warranty in the sale and purchase agreement. This will help to authenticate any future claims made. From a vendor's point of view, the existence of unamortised expenditure could enhance the sale. There is no recovery of development expenditure on sale of the farm as there is with depreciable assets.

Sale of growing crops

Generally, growing crops form part of the land until severed and are not included by the vendor as income. Whether a payment for unharvested crops in existence at the time of sale of land is income depends on the treatment of the purchase price in the sale and purchase agreement. Inland Revenue has stated that where the crop has a price that is shown separately 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* ¶44-112 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* ¶614-115 Vol 6, No 14, June 1995 at 24.

Note that 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 s 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* ¶12-105 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* ¶242-106 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
- the piping surrounds are part of the dairy shed complex comprising the shed and adjoining yard
- the cost of replacing overhead power lines to the dairy shed with an underground system of power is a capital expense and not deductible, and
- the cost of a cattle stop constructed in an opening in a fence is deductible; see QB 12/03: "Income tax — deductibility of expenditure on cattle stops", published in *Tax Information Bulletin* ¶244-109 Vol 24, No 4, May 2012 at 22.

Farm dwelling costs

Note that the discussions below reflect current Inland Revenue practice. However, following a review of these long-standing concessions, in October 2016, Inland Revenue released a draft interpretation statement, QWB00082, "Income tax — deductibility of farmhouse expenses", which is intended to withdraw these concessions with effect from the commencement of a taxpayer's 2017/18 income year. See discussion of the draft item below.

Electricity

A farmer is permitted to deduct all electricity costs attributable to running the farming assets. A deduction of 25% of the cost of electricity consumed by the farming household is also permitted. Should the farm dwelling be occupied by a partner of a partnership that carries on the particular farming business, the partnership is allowed a deduction of 25% of the cost of electricity consumed by the farming household.

Telephone and Internet

The cost of installing a telephone and the actual telephone rental is allowed as a deduction, as are toll calls made in the course of the farmer's business. The cost of monthly Internet charges may be deductible if the general permission is satisfied; however, adjustments will have to be made for any private use.

Interest

Outgoings of dwellings in relation to small farming ventures are generally regarded as wholly private and therefore not deductible. However, for small farming ventures, if it can be established that the dwelling is also used for business purposes, the Commissioner may allow a proportionate amount of the interest expenditure. The Commissioner considers that a small farming venture is one which requires less than 50% of the full-time attention of the proprietor who is actively engaged in other income-producing activities.

Full-time farmers are able to deduct 100% of their interest, as the Commissioner does not require them to apportion interest payable on a mortgage secured on a farm between amounts applicable to the dwelling and the farming business.

Repairs and maintenance

A farmer is allowed a deduction of 25% of the cost of any repairs and maintenance carried out on the farm dwelling. If the farm dwelling is occupied by a partner in a partnership that carries on the particular farming business, the partnership is allowed a deduction of 25% of the cost of any repairs and maintenance.

Rent paid to family trust or associated person

The Commissioner imposes a limitation on the amount of the deduction that may be claimed for rent if the farmer leases the farm property from a family trust (ie of which the farmer or his or her spouse, de facto or civil union partner is the settlor) or an associated person. Thus, the Commissioner allows the farmer a deduction of only 25% of that portion of the farm rental which is attributable to the farm dwelling. The Commissioner uses the following formula to calculate the portion of the farm rental attributable to the farm dwelling:

$$\frac{a}{b} \times c = d$$

where:

a is the cost price of the dwelling as used by the trust or associated person for depreciation purposes

b is the cost price of the farm, and

c is the total annual rental.

With "**d**" being the portion of the rental attributable to the farm dwelling, the farmer is entitled to a deduction of 25% of "d".

Rates

A full-time farmer is permitted a deduction for 100% of the rates paid in respect of the farmer's entire farming property. For small farming ventures, the deduction may include only 25% of that portion of the rates attributable to the land occupied by the farm dwelling.

▶ ***Note:*** *Withdrawal of above concessions*

In October 2016, Inland Revenue released draft interpretation statement QWB00082, "Income tax — deductibility of farmhouse expenses". The draft statement is intended to withdraw and replace the above concessions for farmers with effect from the beginning of a farmer's 2017/18 income year.

The draft statement notes that the concessions have permitted some farmers to claim deductions for private expenditure. The draft statement confirms that deductions for farmhouse expenses are available only to the extent that they are incurred in carrying on the farming business. The previous distinction between a full-time and part-time farmer has been removed. The expenses must satisfy the general permission, ie they must have the necessary relationship both with the taxpayer concerned and the carrying on of the farming business. If an expense satisfies the general permission, it may still not be deductible due to the application of the general limitations. For farmhouse expenses, the private limitation may apply where the person incurring the expense lives in the farmhouse. When a person does live in the farmhouse, any expense incurred on that farmhouse must be apportioned between business and private use based on the facts in that case.

The draft statement states that, generally, for all farming businesses, where it is possible to dissect an expense into deductible and non-deductible amounts, that method should be used first. Where an expense relates to both the business and private use of the farmhouse, dissection may be impractical or impossible. In this situation, the expense will need to be apportioned on some fair and reasonable basis between the business and private portions of

the expense. Apportionment will be necessary when a farmer lives in the farmhouse and uses part of it for business purposes. This will generally arise, for example, when sole traders and partners of partnerships live in the farmhouse. The Commissioner considers that apportionment of farmhouse expenses based on time and space would generally be an appropriate method. This is consistent with other businesses.

On the other hand, some expenses will be incurred on the farm as a whole (including the farmhouse). In this situation, the proportion of the expenses that relate to the private use of the farmhouse must be determined. The Commissioner considers that an appropriate method of apportionment is one that is based on the cost of the farmhouse (being the cost of the farmhouse, curtilage and improvements to the farmhouse) as a proportion of the total cost of the farm and improvements. This is because an apportionment based on time and space might not provide an accurate division between expenses that relate to the farmhouse and expenses that relate to the rest of the farm. Where the costs of the farmhouse and farm are not known, the respective values of the farmhouse and farm may be used. The Commissioner will accept a formal valuation or a reasonable estimate of the values of the farmhouse (including curtilage and improvements) and farm.

For larger farming businesses carried on by sole traders and partners in partnerships, the farmhouse may represent a very small proportion of the overall cost of the farm. In this situation, the private element of any expenses will be minimal. However, the compliance costs associated with calculating deductions for interest and other farmhouse expenses outweigh the tax consequences of any deductions available. Accordingly, the draft statement sets out circumstances in which the Commissioner will accept prescribed levels of deductions for farmhouse expenses incurred by sole traders and partners who live in the farmhouse. This is instead of always requiring deductions for farmhouse expenses to be based on actual use.

The approach is based on a new distinction between:

- farming businesses where the cost of the farmhouse (including curtilage and improvements) is 20% or less of the total cost of the farm (Type 1 farms), and
- farming businesses where the cost of the farmhouse (including curtilage and improvements) is more than 20% of the total cost of the farm (Type 2 farms).

The costs of the farmhouse (including curtilage and improvements) and farm, if known, should be used to determine the extent of the private use of the farmhouse. Where the costs are not known, the respective values of the farmhouse and farm may be used to determine whether the farm is a Type 1 or Type 2 farm. The Commissioner will accept a formal valuation or a reasonable estimate of the values of the farmhouse (including curtilage and improvements) and farm.

Farmers who live in the farmhouse on Type 1 farms may do an actual use calculation if they consider that the business use of the farmhouse is greater than 15%. However, the Commissioner will also accept that 15% of the farmhouse is used for business purposes without any supporting evidence. As a result, such farmers can claim 15% of all farmhouse expenses as deductible business expenses. In addition, these farmers may continue to claim 100% of the interest costs relating to the farmhouse.

For farmers who live in the farmhouse on Type 2 farms, there is no minimum percentage and they must determine whether expenses are deductible under the general permission and general limitations as set out in the draft statement, ie they must claim deductions relating to the actual business use of the farmhouse.

This can be summarised in the following table:

Farm type	Interest charges	Rates charges	General farmhouse expenses	Fixed line telephone charges
Type 1 farms	100% deduction for interest expenses relating to the farm, including the farmhouse.	Dissection where possible, then 15% deduction unless the taxpayer can substantiate a higher deduction.		50% of telephone rental charges used for both business and private purposes, unless the taxpayer can show that 50% is too low.
Type 2 farms	Dissection where possible, then apportion between farm and farmhouse on a fair and reasonable basis. Add back amounts attributable to actual business use of the farmhouse.			50% of telephone rental charges used for both business and private purposes, unless the taxpayer can show that 50% is too low.

The draft statement also discusses the deductibility of farmhouse expenses incurred by a person not living in a farmhouse. The following table summarises the deductibility of farmhouse expenses in a number of different situations.

Entity/ structure	Interest	Other expenses
Partnership or sole trader owns/leases and operates farm	**Sole trader or partner lives in the farmhouse** Apportionment is required. Determine whether the farm is a Type 1 or Type 2 farm and use appropriate method (see above table).	**Sole trader or partner lives in the farmhouse** Apportionment is required. Determine whether the farm is a Type 1 or Type 2 farm and use appropriate method (see above table).
	Farmhouse provided to employee 100% deductible.	**Farmhouse provided to employee** 100% deductible.
	Farmhouse rented at market value 100% deductible.	**Farmhouse rented at market value** 100% deductible.
	Farmhouse provided for no consideration to someone who is not an employee No expenses are deductible.	**Farmhouse provided for no consideration to someone who is not an employee** No expenses are deductible.

Entity/ structure	Interest	Other expenses
		Farmhouse provided to employee 100% deductible.
		Farmhouse provided to shareholder (not an employee) Not deductible as a dividend.
Company owns and operates farm	100% deductible where requirements of s DB 7 met.	**Farmhouse rented at market value** 100% deductible.
		Farmhouse provided for no consideration to someone who is not a shareholder or employee No expenses are deductible.
	Farmhouse provided to employee 100% deductible.	**Farmhouse provided to employee** 100% deductible.
Trust owns and operates farm (trading trust)	**Farmhouse rented at market value** 100% deductible.	**Farmhouse rented at market value** 100% deductible.
	Farmhouse provided to beneficiary who is not an employee No expenses are deductible.	**Farmhouse provided to beneficiary who is not an employee** No expenses are deductible.
Sole trader, partnership, company or trust owns farm, and farmhouse is leased to another entity at market value	100% deductible for the lessor.	100% deductible for the lessor. Lessee (natural person carrying on the farming business) must apportion rent and other expenses. Determine whether the farm is a Type 1 or Type 2 farm and use appropriate method.

Example 1:

Carolyn is a sole trader who owns and operates a dairy farm in Taranaki. The farm is comprised of several titles of land. The farmhouse is situated on only one of the titles. The business use of Carolyn's farmhouse is less than 15%. Carolyn wants to know what proportion of the rates and domestic power bills she can claim as a deduction.

The cost of Carolyn's farm was $2.5m and the cost of the farmhouse was $235,000. The farmhouse therefore represents 9.4% of the cost of the farm. Therefore, Carolyn operates a Type 1 farm.

The power bill is for electricity used in the farmhouse only. Based on the policy outlined in the draft statement, Carolyn will be able to claim a deduction of 15% of the power bill to reflect the use of the farmhouse for the farming business without having to provide evidence of the business use of the farmhouse as a home office.

The farmhouse is situated on one of the titles. All of the other titles are used only for the farming business. Therefore, the rates bills for these other titles are 100% deductible. Carolyn's rates bill for the title that includes the farmhouse includes charges for certain services that are charged per house. The starting point is that those service charges are not deductible because they relate to the private use of the farmhouse. However, 15% of those service charges relate to the business use of the farmhouse and can be deducted. For expenses that relate to the whole farm or are calculated with reference to the value of the farm (ie the

general and fixed charges on Carolyn's rates bill), an area apportionment will often give an unrealistically low proportion relating to the farmhouse. One way of working out a realistic proportion is to calculate the cost of the farmhouse as a proportion of the total cost of the farm and add back any business use of the farmhouse. The cost of the farmhouse is 9.4% of the total cost of the farm. The business use of the farmhouse is treated as being 15%. Carolyn can therefore claim 15% of the 9.4% proportion of the general and fixed rates charges that relate to the farmhouse. This is in addition to the rates charges that relate to the farm business.

Example 2:

Anahera owns and operates a small sheep and goat farm that produces specialty cheeses. Anahera lives in the farmhouse and uses a room in the house as an office for the farm business. Anahera wants to know if she can claim any deductions for the mortgage interest she pays for her farm and farmhouse.

The original cost of the farmhouse was $200,000. Anahera also made improvements to the farmhouse that cost $100,000 in total. The total cost of Anahera's farm was $700,000 (this includes the improvements made to the farmhouse). As a result, the total cost of the farmhouse was $300,000. The cost of the farmhouse is therefore 42.9% of the total cost of the farm. Anahera therefore operates a Type 2 farm and must determine the deductibility of any farmhouse expenses under the general rules. The cost of the farmhouse is 42.9% of the total cost of the farm. Anahera calculates her home office as being 9% of the area of the farmhouse. Therefore, Anahera can claim 9% of 42.9% of the mortgage interest. This is in addition to the mortgage interest that relates to the farm business.

Farm sundries

There are many other materials that a farmer might purchase to meet ordinary and continuous farming requirements. Examples include stock feed, twine, dip and drenches. The Commissioner takes the view that because these sorts of items are not purchased for resale they do not have to be treated as trading stock. For example, any hay acquired upon the purchase of a farm (or acquired during the year for stock feed) is allowed as a deduction when it is possible to attribute a value to the hay. The deduction is available on the basis that it is necessary for the proper carrying on of the farming business. See *Case* E98 (1982) 5 NZTC 59,522.

The prepayments rules apply to purchases of farming sundries. See further at ¶9-011 and ¶10-052.

Fertiliser and lime

The deduction available for expenditure incurred in the acquisition or application of fertiliser or lime may be spread over all or any of the four income years after the income year in which that expenditure was incurred in the proportions the farmer chooses. The concession is exercisable upon the farmer giving the Commissioner notice in writing that the farmer is electing to take advantage of the concession.

It should be emphasised that the option is an alternative to claiming the deduction outright (ie the farmer has the option of spreading the deduction over the four-year period or claiming all of it in the year in which the expenditure was incurred). If a farmer who has made an election to spread the deduction dies or ceases to carry on the farming business before the deduction spread is complete, the balance of undeducted expenditure may be allocated to the income year in which the farmer ceases to carry on the farming business or equally over the income years covering the income year in which the expenditure was incurred and the subsequent income years up until the farming business ceased.

Where two persons are in a partnership and one withdraws, the continuing party's share of the cost of any unexpended balance of fertiliser or lime is allowed against that person's income in the remaining years of election. The withdrawing partner will generally be subject to the cessation of business provisions (see ¶23-050), unless that person commences farming independently. In such a case, the ex-partner's share of the remaining cost can be claimed against individual farming income in the remaining years of election.

Inland Revenue released *Determination* DEP 81: "Fertiliser storage facilities and remedial matters relating to the depreciation of buildings and grandparented structures", following the issue of interpretation statement IS 10/02, "Meaning of 'building' in the depreciation provisions" (published in *Tax Information Bulletin* ¶225-114 Vol 22, No 5, June 2010 at 24). The statement concluded that a building is a structure that has walls and a roof, is of considerable size, is meant to last a considerable period of time and is generally fixed to the land on which it stands. A building is a structure that can function independently of any other but is not necessarily a physically separate structure.

The effect of IS 10/02 is that some assets that were not previously regarded as buildings now come within the meaning of "buildings". Those assets include barns, including drying barns, and fertiliser works. Assets that were acquired, or for which a binding contract was entered into for their purchase or construction, on or before 30 July 2009 continue to be treated as structures for depreciation purposes. DEP 81 clarified that the existing rates continue to apply to the grandparented structures and set general depreciation rates for fertiliser storage facilities that are associated with fertiliser works, by adding a new asset class in the "Building and structures" asset category. Fertiliser storage facilities are buildings within the definition of "building" in IS 10/02 and they have an estimated useful life of 33.3 years.

Grass

Regrassing and fertilising expenditure that is part of a significant capital activity (as defined in s YA 1, see ¶27-165) should be capitalised and amortised. All other regrassing and fertilising expenditure is fully deductible in the year incurred. Pasture that has an estimated useful life of one year or less is specifically excluded from the capital treatment. Also excluded from the capital account treatment are costs associated with changes in the intensity of farming activities. See *Tax Information Bulletin* ¶185-120 Vol 18, No 5, June 2006 at 123.

Legal expenses

The Commissioner allows a deduction for legal expenses incurred in raising a mortgage to buy farm property or in borrowing money for farming purposes. A deduction is also allowed for any legal expenses incurred in buying any other farm assets. However, unless s DB 62 applies (see below) no deduction is permitted for legal costs, such as conveyancing fees, incurred in acquiring the asset. Also allowed as a deduction are any legal expenses incurred in connection with the initial entering into or subsequent renewal of lease of farm property or farm assets. Legal costs incurred in the preparation of sharemilking agreements are also deductible. A farmer, carrying on a business, is entitled to utilise the provision related to business-related legal expenses under s DB 62 that allows total legal expenses up to $10,000 incurred in an income year to be fully deductible in that year. The deduction provision in s DB 62 overrides the capital limitation. The subject of legal expenses generally is considered at ¶10-680.

Motor vehicles

The deduction available to a farmer for motor vehicle expenses is no different from deductions for any other person. When a farmer reimburses an employee, the farmer generally will have three choices. These are reimbursing expenditure, providing an allowance, or making a payment based on mileage rates. For more detail, see ¶3-445 and ¶10-710.

Repairs and maintenance

The deduction available to a farmer for repairs and maintenance expenses is no different from deductions for any other person. For more detail, see ¶10-840 and also above under "Farm dwelling costs".