

## FACT SHEET

# Cash basis persons under the financial arrangements rules

Issued: 26 July 2022

IS 22/05 FS

This fact sheet accompanies interpretation statement **IS 22/05** which explains when a person can account for income and expenditure from financial arrangements on a cash basis instead of an accrual basis. The statement also sets out the adjustment that must usually be made when a person ceases to be a cash basis person and must account for their financial arrangements using the accrual basis.

This item is relevant for New Zealand tax residents, both natural persons and entities, with financial arrangements who may be eligible to account for income and expenditure as a cash basis person.

## RELATED DOCUMENT

**Interpretation Statement IS 22/05:** Cash basis persons under the financial arrangements rules

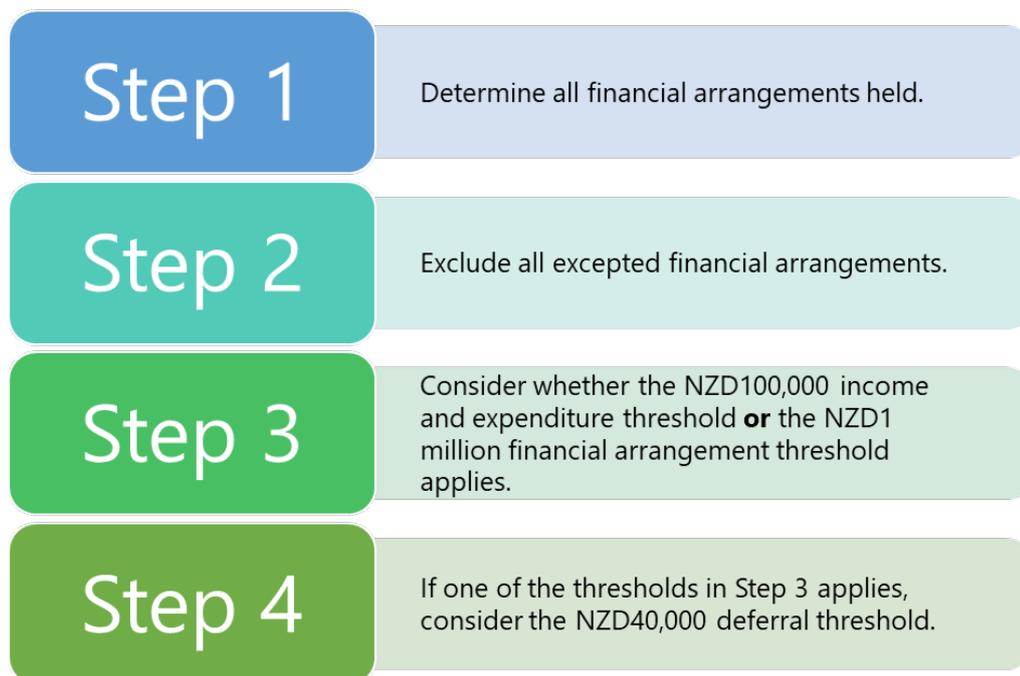
## Key terms

<p><b>The financial arrangements rules (FA rules)</b></p>	<p>The FA rules essentially require parties to a financial arrangement to spread income or expenditure from the arrangement over its term. The rules mainly apply to New Zealand tax residents.</p>
<p><b>Financial arrangements (FAs)</b></p>	<p>Financial arrangements occur when money is received now in consideration for money to be paid later unless specifically excluded by the Act. The tax treatment of financial arrangements is governed by the FA rules. Examples of FAs are loans and bank accounts.</p>
<p><b>Excepted financial arrangements (EFAs)</b></p>	<p>Some arrangements are excluded from being financial arrangements and are taxed under general or specific rules. Two examples are shares and foreign loans for private or domestic purposes for cash basis persons.</p>
<p><b>Cash basis persons (CBPs)</b></p>	<p>A CBP accounts for their FAs by returning income when it is received and claiming expenditure when it is paid. A CBP is not required to apply any of the spreading methods to their financial arrangements, unless they elect to do so.</p>
<p><b>Non-cash basis persons</b></p>	<p>A non-cash basis person accounts for income and expenditure from a financial arrangement on the accrual basis. They spread income and expenditure over the term of the arrangement, regardless of when it has actually been received or paid. The accrual basis may require complex calculations to determine the amounts of income and expenditure allocated to each year.</p>
<p><b>Cash basis adjustments (CBAs)</b></p>	<p>A CBA is usually performed when a person's status changes – from cash basis person to non-cash basis person (or vice versa), or if they elect to use a spreading method.</p>
<p><b>Base price adjustments (BPAs)</b></p>	<p>A BPA is a wash-up calculation and must usually be performed when a financial arrangement ends – for example, a loan is repaid, or the person stops being a New Zealand tax resident. Both CBPs and non-cash basis persons must usually do a BPA.</p>

## Being a cash basis person

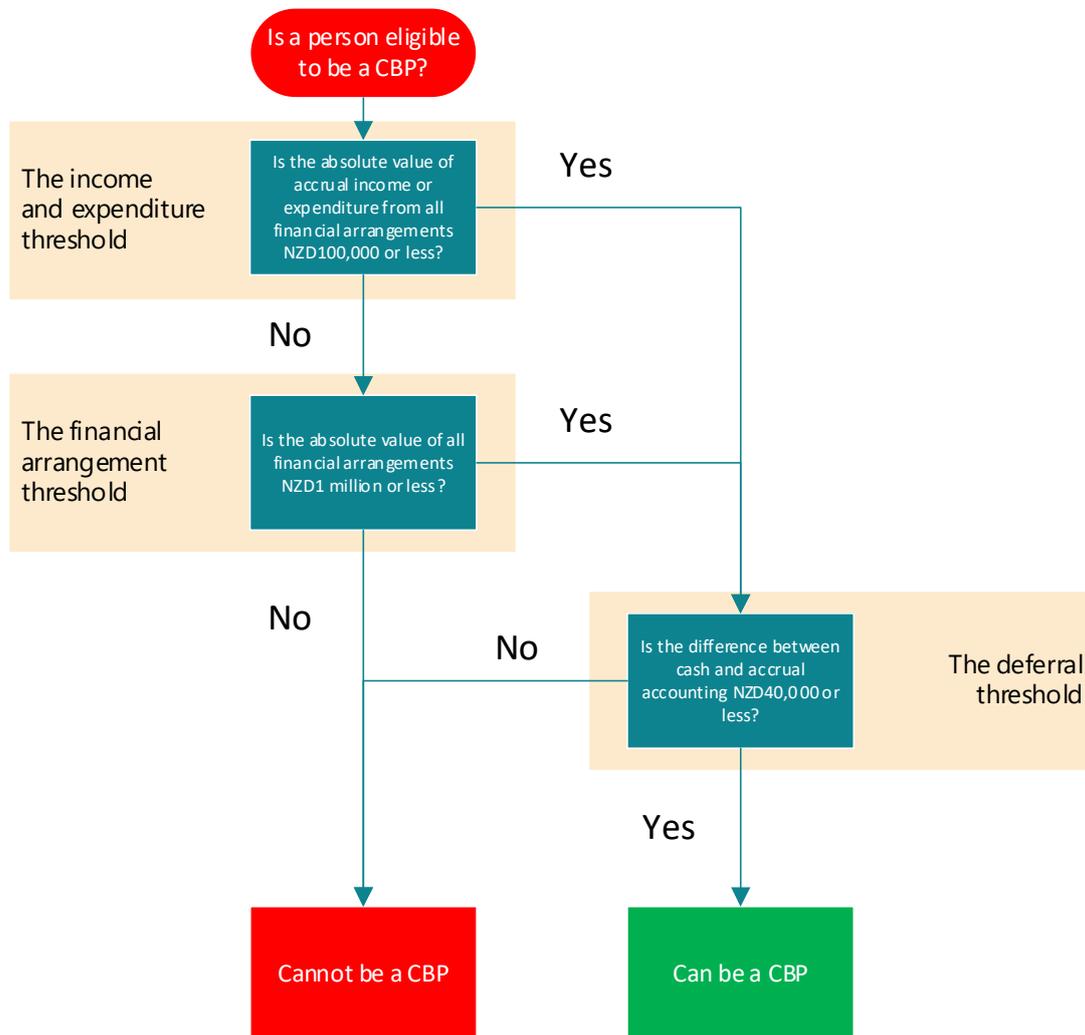
1. Under the FA rules, a CBP can account for income when it is received and for expenditure when it is paid during the life of a financial arrangement. A non-CBP must use a spreading method.
2. Both individuals and entities can potentially be a CBP. There are four steps to determining whether a person can be a CBP as shown below in Figure 1.

**Figure 1 - The four steps**



3. The first step is to identify all financial arrangements the person holds, such as loans and bank accounts. The second step is to exclude all EFAs, such as shares.
4. The third and fourth steps require calculating whether the person's financial arrangements are under certain thresholds:
  - the NZD100,000 income and expenditure threshold
  - the NZD1 million financial arrangement threshold
  - the NZD40,000 deferral threshold
5. The decisions a person must make are summarised in Figure 2.

**Figure 2 – Is a person eligible to be a CBP?**



6. Determining whether the thresholds at Step 3 are exceeded involves adding the values of all income and expenditure from the financial arrangements, and separately the values of all financial arrangements. This means adding income and expenditure, and assets and liabilities together as if they are all positive numbers. For example, income of NZD5,000 and expenditure of NZD3,000 equals NZD8,000, not NZD2,000. The person needs to meet the thresholds each year to remain a CBP.
7. A person can elect to use a spreading method even if they qualify as a CBP. However, if a person makes an election they must apply it to all financial arrangements. A person can revoke an election but it will only apply to new financial arrangements in the year after the revocation.

## Making a cash basis adjustment

8. A person calculates a CBA when:
  - they elect to use a spreading method
  - they become a CBP
  - they cease to be a CBP.
9. **IS 22/05** explains how to calculate a CBA and provides a worked example.
10. A CBA puts a person in the same position as if they had used the new method from the beginning of the arrangement to the end of the current income year.
11. If the CBA is positive, it is income for the person in the year the CBA is calculated. If the CBA is negative, it is expenditure incurred by the person in the year the calculation is made. It is still necessary to consider whether that expenditure is deductible.

## About this document

Some of our longer or more complex items are accompanied by fact sheets, which summarise and explain the main points.