Binding rulings

This section of the TIB contains binding rulings that the Commissioner of Inland Revenue has issued recently.

The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates tax liability based on it.

For full details of how binding rulings work, see our information booklet "Binding Rulings" (IR 115G) or the article on page 1 of TIB Volume Six, No.12 (May 1995) or Volume Seven, No.2 (August 1995). You can order these publications free of charge from any Inland Revenue office.

Financial planning fees: income tax deductibility

Public ruling - BR Pub 95/10

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation law

This ruling applies in respect of sections BB 7, BB 8, CB 1 - CB 15, EE 1, EF 1, and EH 1 - EH 9 of the Income Tax Act 1994.

Arrangements to which this ruling applies

This ruling applies when taxpayers incur fees for financial planning services. "Fees for financial planning services" means planning fees, implementation fees, and monitoring fees for the purposes of this ruling.

"Planning", "implementation", and "monitoring" services have the following meanings for the purpose of this ruling.

Planning services are the services provided by an adviser when the adviser plans an investor's portfolio of investments. Planning services are often provided at the outset of the portfolio's establishment, but can also be provided as part of the adviser's ongoing service.

Implementation services are the services provided by an adviser when the adviser implements an investor's financial plan. Implementation services also include the services provided when a custodian implements the plan, and an adviser charges the investor a fee. However, if an adviser's fee in such a situation relates to monitoring services, the services are not implementation services.

Monitoring services are the services provided by an adviser when the adviser monitors and evaluates the performance of an investor's portfolio. Monitoring services include the collection of income from investments, and the exchanging of foreign currency.

The period for which this ruling applies

This ruling applies to fees for financial planning services incurred within the period 1 April 1996 to 31 March 1999.

The ruling

Passive investors

Passive investors are investors who are not speculative investors, nor in the business of investing.

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Planning services

Taxpayers who are passive investors cannot deduct fees paid to financial advisers for planning services. Fees paid for planning are capital expenses and not deductible because of the operation of section BB 8 (a). Fees paid for planning may also be not deductible for the further reason that they do not satisfy section BB 7.

Implementation services

Taxpayers who are passive investors cannot deduct fees paid to financial advisers for implementation services. Fees paid for implementation are capital expenses and not deductible because of the operation of section BB 8 (a).

For passive investors the deductibility of implementation fees is subject to the qualified accrual rules in sections EH 1 to EH 9.

Monitoring services

Passive investors can deduct fees paid for monitoring investments under section BB 7 (a), when those fees are incurred.

However, to the extent that monitoring fees are "accrual expenditure", the deduction of those fees will be affected by section EF 1. Thus the unexpired portion of any such expenditure must be included in the assessable income of the passive investor for the income year.

Business investors and speculative investors

Speculative investors are investors who acquire an investment with the intention of selling it, or carry on or carry out an undertaking entered into or devised for the purpose of making a profit.

Persons are in the business of investing when the nature of their activity, and their intention in respect of the activity, is sufficient to amount to a business.

Taxpayers in the business of investing and taxpayers who are speculative investors can deduct all planning, implementation, and monitoring fees, when incurred, under section BB 7.

For speculative investors, the deductibility of implementation fees is subject to the qualified accrual rules in sections EH 1 to EH 9.

For business investors, the deductibility of implementation fees is subject to the qualified accrual rules in sections EH 1 to EH 9, and where the qualified accrual rules do not apply, the trading stock provisions of section EE 1.

To the extent that fees are "accrual expenditure", the deduction of those fees will be affected by section EF 1. Thus the unexpired portion of any such expenditure must be included in the assessable income of the investor for the income year.

Financial arrangement implementation fees

For passive, speculative, and business investors, there is a special treatment for the deductibility of financial arrangement implementation fees. Such fees must be dealt with under the qualified accruals rules. For such fees the distinction between passive, speculative, and business investors is often no longer important as the deductibility of the fees is provided for by statute. There are, however, some exceptions to the statutory deductibility of the fees where the distinction between passive, speculative, and business investors is still important.

Implementation fees that are part of the "acquisition price" of the financial arrangement will be allowed as a deduction against income earned from the financial arrangement either:

- On the maturity, remission, or sale of the financial arrangement for cash basis holders; or

- Over the life of the financial arrangement for non-cash basis holders.

Implementation fees that are part of the acquisition price of the financial arrangement include:

- Contingent fees to the extent that they are provided in relation to the financial arrangement; and
- Non-contingent fees to the extent that they exceed 2% of the core acquisition price, and to the extent they are provided in relation to the financial arrangement.

Non-contingent fees that are no more than 2% of the core acquisition price are deductible under the normal rules for deducting financial planning fees. In this case, the distinction between passive, speculative, and business investors is important.

Fees incurred in producing non-assessable or exempt income

No deduction is available to any type of investor for fees to the extent that the fees are incurred in the production of non-assessable or exempt income.

This ruling is signed by me on the 18th day of December 1995.

Martin Smith
General Manager (Adjudication & Rulings)

Analysis of public ruling BR Pub 95/10

This analysis of the ruling does not form part of the ruling.

The subject matter of this ruling was previously contained in TIB Volume Five, No.10 (March 1994) at page 4. This ruling replaces that earlier item.

All references are to the Income Tax Act 1994 unless otherwise indicated.

Background

What are financial planning fees?

Financial advisers charge for services provided to their clients. In the ruling, these services are broken down into three components. Financial advisers may use different names for these component services. The tax treatment of the fees depends not on the name of the service, but on the nature of the service. To determine the correct tax treatment of a service, it is important to identify the exact service a financial adviser provides.

In the ruling the following terms refer to the range of services discussed below:

- Planning
- Implementation
- Monitoring.

1. Planning

Planning occurs when the investor seeks detailed advice from an adviser. This service may be provided when the investor contacts the adviser for the first time. The investor and adviser meet to establish the investor's investment requirements and ability to meet those requirements.

The adviser assesses the investor's current financial position, which may include assessment of investments, savings objectives, cash requirements, and life and general insurance requirements. For corporate or trustee investors, factors assessed may differ.

The adviser then prepares a plan including a range of investment proposals for the investor, and recommends how the investor's goals can best be met.

Planning services may also be provided as part of the financial adviser's on-going service. Using information received from monitoring an investor's portfolio, the financial adviser may recommend changes to the investor's investments. The changes may be made to bring the investor's portfolio into line with the investor's goals and risk profile, to take advantage of better or new opportunities, or to take into account a change in the investor's requirements. Some financial advisers may call a fee for this service a monitoring fee. In this situation this service is better described as a planning fee.

Calculation of the fee charged for planning services varies between advisers. Many advisers charge a flat fee, irrespective of the complexity of the plan. Others charge fees based on the complexity of the plan. The fee may be based on the amount of time spent by the adviser, or it may be a percentage of the funds invested. Some advisers only charge planning fees when the investor adopts the plan.

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2. Implementation

Implementation is the service provided when an adviser places investments. Implementation may occur when a financial plan is first implemented, and when investments are later bought and sold.

Often financial advisers use another organisation (a "custodian") to place investments. Advisers pass on the custodian's implementation charge to the investor, either within their fee, or separately as a disbursement.

Sometimes financial advisers charge investors for initial investments, but not for any later changes to the investments. Other financial advisers do not charge separately for later implementation fees, and instead include charges for changes to investments in a global monitoring fee. If so, the fee paid for implementation will need to be separately identified for tax purposes. Without separately identifying the implementation fee included in the global fee, it will not be possible to calculate the deductible and non-deductible portions of the global fee.

Implementation fees include fees payable to investment fund managers for entry into the investment.

Some financial advisers charge a large fee when an investment is first made, which equates to the value of a commission otherwise payable to the financial adviser by the fund manager of the investment. The financial adviser may prefer to recover fees from investors rather than through commission from fund managers to remain impartial. The tax treatment of such a charge depends on what services the financial adviser provides. A financial adviser may provide monitoring services for the fee, or simply charge the amount that would otherwise have been received by way of commission as an initial cost. If no services are provided, and the fee is an initial cost, the fee is for implementation services.

3. Monitoring

Monitoring involves the adviser monitoring and evaluating the performance of the investor's portfolio. Monitoring services include collecting data on the investor's investments, and events and research material that have implications for the investor; and reporting to the investor on this data.

The financial adviser may also evaluate performance of the investment portfolio (which includes performance of fund managers and the adviser) in terms of the investor's goals, and relay this information to the investor.

Monitoring may include arranging the collection of income from investments and exchanging currency.

Monitoring fees are usually charged as a percentage of the investment funds under the adviser's management.

For passive investors, monitoring is typically on an annual or semi-annual basis. For business investors, monitoring may be more regular.

Types of investor

The income tax treatment of planning, implementation, and monitoring services differs, depending on whether the investor is:

- A passive investor
- A speculative investor
- In the business of investing.

These types of investor are defined for the purposes of the ruling, and are discussed in more detail below.

When is an investor a passive investor?

Investors are passive investors when they are not speculative investors, or in the business of investing. Generally, investors are passive investors, as most investors are not in the business of investing and are not speculative investors.

When is an investor a speculative investor?

A speculative investor is someone who either:

- Acquires an investment with the intention of selling it; or
- Carries on or carries out an undertaking or scheme entered into or devised for the purpose of making a profit.

Profits derived or losses incurred in those circumstances are assessable under section BB 4 and deductible under section BB 7.

Investors are not speculative investors simply because they would like to see their investment capital increase, or that they may sell their investment if the capital increases. Most passive investors fall within that description.

An investor may be a speculative investor in relation to one investment, and not in relation to another. An example might be an investor who has a number of financial arrangements and investments in unit trusts, and decides as a single transaction to buy some listed shares with the intention of selling them in the next month or so. Planning and implementation fees related to the unit trusts would not be deductible, but any fees to the extent that they related to the shares would be deductible. (For the deductibility of the fees relating to the financial arrangements, see the discussion under the heading *Qualified accruals rules and implementation fees*.)

When is an investor in business?

Section OB 1 defines "business" to include:

any profession, trade, manufacture, or undertaking carried on for pecuniary profit.

Whether a taxpayer is in the business of investing is dependent on that taxpayer's fact situation. The tests and criteria established by cases such as *Grieve v CIR* (1989) 6 NZTC 61,682 and *CIR v Stockwell* (1992) 14 NZTC 9,191 are relevant to this question.

The leading "business" case in New Zealand is that of *Grieve*. In that case the Court of Appeal concluded that there are two aspects to the concept of a business:

- The nature of the activity; and
- The intention with which the taxpayer undertakes the activity.

This approach was followed in *Stockwell*. The decision in *Stockwell* is useful in determining whether an individual is in the business of investing.

In *Stockwell* the Court of Appeal discussed, as obiter dicta, the question of when a taxpayer is in business. The Court observed that the question of whether a taxpayer was in business for tax purposes depended on whether the activities undertaken by the taxpayer were sufficiently continuous and extensive to constitute being a business. That is a question of fact and degree and is dependent upon the taxpayer's particular fact situation.

In *Grieve*, Richardson J set out some factors relevant to the inquiry as to whether a taxpayer is in business. They were:

- The nature of the taxpayer's activities; and
- The period over which the taxpayer engages in the activity; and
- The scope of the taxpayer's operations; and
- The volume of transactions undertaken; and
- The commitment of time, money, and effort by the taxpayer; and
- The pattern of activity; and
- The financial results achieved by the activity.

These factors were reiterated by the Court of Appeal in *Stockwell*. The Court commented that the test is objective rather than subjective. Taxpayers' intentions are, therefore, evidenced by their activities (the extent and continuity), not by their own personal view of their activities. In *Stockwell* the Court of Appeal also provided some observations or guidelines regarding the extent and continuity of activity required to constitute a business:

- The fact that a taxpayer's activity is sufficient to render his or her returns assessable under section 65(2)(e) (now section BB 4 (c)) does not mean that their activity is a business.
- Where the taxpayer's activity is merely a means of supplementing an already adequate income, the taxpayer is unlikely to be in the business from which that supplementary income is derived.
- If the taxpayer is in full-time employment and engages in a spare-time activity, the presumption will be against that spare-time activity being a business.
- If the taxpayer is either unemployed or retired and is only engaged in moderate (investment) activity, the presumption is against that activity being a business.

Ultimately, whether a person is in the business of investing will be a question of fact. In seeking to determine whether a taxpayer is in the business of investing, the Commissioner uses the criteria identified above from the *Grieve* and *Stockwell* decisions.

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
BB 4 (a)	65(2)(a)
BB 4 (c)	65(2)(e)
BB 6	101
BB 7	104
BB 8 (a)	106(1)(a)
BB 8 (c)	106(1)(k)
CB 1 - CB 15	61
CE 1 (a)-(c)	65(2)(j)-(jb)
EE 1	85
EF 1	104A
EH 1 - EH 9	64C - 64M

Deductibility

Expenditure can be deducted from assessable income if it is provided for in the Income Tax Act 1994. Section BB 6 states:

Except as expressly provided in this Act, no deduction shall be made in respect of any expenditure or loss of any kind for the purpose of calculating the assessable income of any taxpayer.

Section BB 7 which is the general deductibility section, states:

In calculating the assessable income of any taxpayer, any expenditure or loss to the extent to which it -

(a) Is incurred in gaining or producing the assessable income for any income year; or

(b) Is necessarily incurred in carrying on a business for the purpose of gaining or producing the assessable income for any income year -

may, except as otherwise provided in this Act, be deducted from the total income derived by the taxpayer in the income year in which the expenditure or loss is incurred.

Prohibition on deductibility

Section BB 8 qualifies the general deductibility test in section BB 7.

Section BB 8 (a) prohibits the deduction of capital. It denies a deduction for:

Investment, expenditure, loss, or withdrawal of capital; money used or intended to be used as capital; money used in the improvement of premises occupied; interest which might have been made on any such capital or money if laid out as interest; the acquisition price of any financial arrangement to which the qualified accruals rules apply:

Provided that this paragraph shall not deny a deduction in respect of any amount of expenditure deemed to be expenditure under the qualified accruals rules.

Section BB 8 (c) prohibits a deduction where the expense relates to exempt income. It denies a deduction for:

Any expenditure or loss to the extent to which it is incurred in gaining or producing income which is exempt from income tax.

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Assessability

Section BB 4 is the general assessability provision. It specifically provides that certain types of income are assessable. Section CE 1 further defines income. The following income types are relevant to this item:

- Business profits - section BB 4 (a).
- Personal property sales - section BB 4 (c).
- Interest, dividends, and annuities - section CE 1 (1)(a).
- Benefits from money advanced - section CE 1 (1)(b).
- Accruals income - section CE 1 (1)(c).

Qualified accruals rules

The qualified accruals rules in part EH provide rules for the timing and recognition of income derived and expenditure incurred in respect of financial arrangements. The "core acquisition price" needs to be determined at the end of the life of a financial arrangement to determine the amount of income or expenditure arising from the financial arrangement that has not already been returned. The "acquisition price" is defined in section OB 1 to include any consideration provided "in relation to a financial arrangement".

Trading stock

Under section EE 1 (8), the value of trading stock at the end of the income year is included in a taxpayer's assessable income, and under section EE 1 (9), the value of trading stock at the beginning of the year is allowed as a deduction in calculating a taxpayer's assessable income for that income year.

Under section EE 1 (3), the value of trading stock is, at the taxpayer's option, cost, market value, or replacement value.

Application of legislation

Passive investors - deductibility of fees

Planning fees

Planning fees are not deductible to passive investors because they are capital expenditure. In some situations, planning fees are not deductible for the further reasons that they are not deductible under the general deductibility section, or because they relate to non-assessable or exempt income.

The general deductibility section is section BB 7. Section BB 7 (a) applies to passive investors, speculative investors, and business investors if the planning expenditure is incurred in gaining or producing assessable income.

Section BB 7 (b) does not apply to passive investors or speculative investors because it only applies to expenditure incurred in carrying on a business.

Section BB 7 is subject to section BB 8. Section BB 8 (a) prohibits the deduction of capital expenditure. "Capital" is not defined. The Courts have had to decide whether expenditure is capital in numerous cases. Often they examine various tests to decide whether expenditure has the features of capital, although they emphasise that tests are merely a guide and the particular facts of each situation will determine the matter. Also, a number of the tests have been developed to analyse the capital/revenue distinction in the context of a business. The tests that examine business expenditure are not necessarily applicable to passive and speculative investors. Nonetheless, the tests serve to distinguish between expenditure connected with the profit-making structure and regular out-goings incurred as part of the normal operation of that structure, so are of some relevance.

A passive investor's financial assets are capital assets of the investor. Any gain or loss of the investor, being the difference between the price the investor paid and the amount received on disposal, is not assessable because it is capital, not income. The assets are capital in nature because they are the investor's structure from which income is derived.

In deciding whether planning fees are capital or income, the question is whether the fees are incurred in relation to the capital assets, or in relation to the income that an investor derives from those assets.

The Privy Council in *BP Australia Ltd v FCT* [1965] 3 All ER 209, cited with approval in various judgments of the New Zealand Court of Appeal, followed the approach of Dixon J in *Sun Newspapers Ltd v FCT* (1938) 61 CLR 337, who said that there were three matters to consider when determining whether expenditure is capital or income:

- The character of the advantage sought
- The manner in which it is to be used, relied upon or enjoyed, (and in this and the preceding factor recurrence may be relevant)
- The means adopted to enjoy it.

In *BP Australia Ltd* the Privy Council analysed the character of the advantage sought by the expenditure using a number of tests. The Privy Council considered:

- The need or occasion which calls for the expenditure
- Whether the payments were paid out of fixed or circulating capital
- Whether the payments were of a once and for all nature producing assets or advantages which are of an enduring benefit
- How the sum in question would be treated on ordinary accounting principles
- Whether the sums were expended on the structure within which the profits were to be earned or as part of the income-earning process.

The approach adopted by the Privy Council was to consider what the expenditure was calculated to effect.

The first test mentioned in *Sun Newspapers*, and examined in *BP Australia Ltd*, was the character of the advantage sought. In the context of financial planning fees, the effect the investor wishes to achieve is a plan or strategy for investing his or her financial assets to achieve investment goals. The need or occasion for the expenditure is the investor's decision to examine his or her financial assets, and to receive advice on whether these assets should be retained or disposed of for new assets. The investor incurs a planning fee for advice on whether assets should be sold, and which new assets or type of assets should be obtained. The advice received relates to the investor's capital assets.

An investor does not receive planning advice directly to increase assessable income. The direct purpose of planning advice is to obtain advice on the best mix of investments to achieve the investor's investment goals. The result the investor wishes to achieve may be to derive more income from his or her investments, or it may be another result. The investor may wish to reduce or increase the risk of a portfolio, or may wish to change investments to produce tax-paid returns on retirement. He or she may wish to change from intangible assets to property investments. Planning advice relates to the investor's capital assets, which are the investor's profit-earning structure, rather than to the profit-making process.

Analysis of whether planning advice is capital or income may be similar to analysing whether fees for legal and other professional advice are capital or income. It may not always be possible to point to an enduring asset. As with professional advice, the test is to determine whether the expenditure is incurred in relation to the profit-earning structure, or the profit-making process. In *Foley Bros Pty Ltd v FC of T* (1965) 13 ATD 562, the full High Court of Australia held that in examining the matter to which legal fees related, "the true contrast is between altering the framework within which income producing activities are for the future to be carried on and taking a step as part of those activities within the framework".

The expenditure is incurred to achieve an enduring advantage. This test of capital is not whether expenditure results in a permanent, tangible asset (*Kemball v C of T* [1932] NZLR 1305, *John Fairfax and Sons Pty Ltd v FC of T* (1959) 101 CLR 30). The test is whether the expenditure is incurred to obtain an advantage or something of lasting value. The financial adviser provides a plan that becomes the investment framework for the investor. The plan is of continuing benefit to the investor because it forms the investor's strategy. Using the investor's goals, the adviser provides an approach to investment that takes into account those goals, and may identify particular investments that will enable those goals to be achieved. Over time, particular investments may no longer serve the purpose of achieving the investor's goals, and the adviser may recommend new investments. When that happens, the adviser's new advice also relates to bringing into effect the investment strategy.

The time that a plan is of value to an investor will vary. It will be unusual for a plan to be developed each year. Although aspects of the plan may change as the performance of a particular investment changes, or if the investor's goals change, the plan is nonetheless something of lasting value, rather than something that is a regular, recurring expense incurred in deriving investment income.

The test that examines whether expenditure relates to fixed or circulating capital is not usually relevant to a passive investor. "Fixed capital" and "circulating capital" are relevant terms to a business that has fixed plant and circulating capital that is turned over while making profits. They may also be terms relevant to a speculative investor who buys and sells assets that are circulated to derive a profit. A passive investor will usually retain investments for a reasonable period, and not turn them over to realise the gain in the investment.

Usually, it will not be of much assistance to determine how the expenditure is treated on ordinary accounting principles. A passive investor will often not keep accounts in the way a business will.

The other two considerations mentioned in *Sun Newspapers* are the manner in which the benefit obtained by the expense is used, relied upon, or enjoyed, and the method of payment. The benefit will be used as the investor's on-going investment strategy. The advice forms the basis for investment of the investor's capital assets. The method of payment is usually a one-off payment when a plan is first prepared. Further payments may also be made for planning advice if the adviser suggests modifications to the investor's portfolio, or if the investor's goals change. The method of payment suggests that planning fees are not regular payments for expenses related to the investor's income.

The discussion so far has focused on the prohibition for deduction of capital expenditure in section BB 8 (a). For passive investors, fees for financial plans may also not be deductible because they fail the general deductibility test under section BB 7. The fees may not have the requisite connection with assessable income to satisfy the test for deductibility under section BB 7 (a). When the plan is developed, the investor may not have decided whether to implement the plan. The investor may have received other advice, and see the plan as a possible method of capital asset reorganisation. There may not be a direct link between the plan and deriving assessable income from investments taken out on the advice contained in the plan. If the investor has already put a plan in place, and receives further advice from an adviser to achieve new goals, then the necessary connection with assessable income may be present. However, as discussed above, the fees will not be deductible because they are capital in nature.

The link between assessable income and planning fees also will not be present when investments taken out on the advice in a plan are tax-paid investments, e.g., insurance bonds. Fees paid for investments that do not lead to assessable income are not deductible for any investor, even if the investor is in the business of

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investment or is a speculative investor. This point is discussed below under *Fees incurred in gaining or producing non-assessable or exempt income.*

Implementation fees

Implementation fees are capital expenditure and not deductible by passive investors.

Implementation fees are directly related to changing the structure of the investor's income earning structure, and are not related to the income earning process. The effect achieved is that the investor obtains a new capital asset. The investment asset obtained as a result of the investor incurring an implementation fee will endure, because a passive investor does not buy and sell financial assets frequently and will hold the asset for a time. Implementation fees are not regular or recurring expenses.

In *Case U53* 87 ATC 351 the taxpayer paid a fee called a service fee that was calculated as a percentage of the value of units the investor bought in a unit trust. (The same unit trust was involved in *Case U160* 87 ATC 935.) The investment document stated that the service fee was for payment in advance for services to be rendered throughout the life of the fund. There was no description of the nature of the services outlined in the prospectus of the unit trust. The Tribunal in both cases held that the charges on the basis of a percentage of funds invested indicates that if any services were to be rendered, they would not be in the nature of management services, which were provided for elsewhere in the investment documents. The Tribunal in both cases held that the service fee was in reality part of the cost of the units and was a capital cost.

On the basis of *Case U53* and *Case U160*, fees that are an entry cost are non-deductible implementation fees. It will be a question of fact in each case whether fees are paid for monitoring services, or whether the fees are an implementation cost.

An exception to the general position that implementation fees are not deductible to passive investors relates to implementation fees that are part of the cost of "financial arrangements". This exception is discussed under *Qualified accruals rules*.

Monitoring fees

Monitoring fees are deductible by passive investors under section BB 7 (a).

These fees are paid for the adviser to monitor the performance of the investor's investments, and to provide administrative services such as collection of income. These are management services that are part of the process of the investor earning assessable income from investments. The services relate more to the returns from the investments than the investments themselves. Monitoring fees are often regular, on-going expenses. The investor does not receive an enduring advantage as a result of monitoring.

To the extent that monitoring fees are "accrual expenditure", the deduction of those fees will be affected by section EF 1. Thus the unexpired portion of any such expenditure shall be included in the assessable income of the passive investor for the income year.

Example 1

Investor A is an investment adviser employed by Bank. He spends most of his day advising investors of their investment opportunities and implementing investments for them.

Investor A and his wife have a young family and have recently bought a larger house. The extent of their personal investments is minimal. Besides Investor A's membership of a superannuation scheme operated by Bank, Investor A and his wife have a few thousand dollars invested as a lump sum in a managed fund. They approached a financial adviser for advice on which fund to invest in.

The continuity and extent of Investor A's investment activities make it unlikely that he is in the business of investing. His employment activities of investment advice do not have any bearing on his personal activities. They must be viewed separately.

Investor A is a passive investor; only the monitoring fees are deductible.

Example 2

Investor B is a retired bank manager. Throughout his professional career he has acquired a number of investments from which he has continued to derive both income and capital growth. Investor B uses the services of a financial adviser in managing his investments. While Investor B takes an interest in the performance of his investments, he leaves the majority of the work to his financial adviser. Investor B only undertakes a minimal amount of buying and selling. Except for some superannuation entitlements, Investor B derives all his income from these investments.

Investor B is not in the business of investing. Although the investments represent the majority of his income, his activities lack sufficient extent and continuity to constitute a business of investing. Cooke P in *Stockwell* considered there would be a presumption against a taxpayer being in the business of investing where a retired person undertook merely modest investment activity. The fact that the investments represent a taxpayer's primary source of income does not automatically make the activity the taxpayer's business.

Investor B is a passive investor; only the monitoring fees are deductible.

Speculative investors

Planning fees, implementation fees, and monitoring fees

Speculative investors can deduct planning fees, implementation fees, and monitoring fees under section BB 7 (a). Like investors in the business of investing, any difference between the cost of the investment and the amount received on disposal of the investment is assessable income or a deductible loss to speculative investors. Their investments are trading assets not capital assets. Therefore, fees incurred in relation to speculators' investments are not incurred in relation to their capital structure.

The timing of deductions for implementation fees for speculative investors is subject to the qualified accruals rules (discussed below).

To the extent that fees are "accrual expenditure", the deduction of those fees will be affected by section EF 1. Thus the unexpired portion of any such expenditure shall be included in the assessable income of the speculative investor for the income year.

Investors in the business of investing - deductibility of fees

Planning fees, implementation fees, and monitoring fees

Investors in the business of investing can deduct planning fees, implementation fees, and monitoring fees under section BB 7 (a) or section BB 7 (b).

If an investor is in the business of investing, any difference between the cost of the investment and the amount received on disposal of the investment is assessable income or a deductible loss. The investments are trading assets and not capital assets of the investor. Therefore, fees do not fail the test of deductibility for the reason that they relate to the investor's capital profit-making structure.

To the extent that fees are "accrual expenditure", the deduction of those fees will be affected by section EF 1. Thus the unexpired portion of any such expenditure shall be included in the assessable income of the business investor for the income year.

Planning fees

For business investors planning fees are deductible under section BB 7 (a) or (b) as they have the necessary connection with assessable income.

Implementation fees

The timing of deductions for implementation fees for business investors is subject to either the qualified accruals rules (discussed below), or the trading stock provisions. If the accruals rules apply, they take precedence over the rules applying to trading stock.

Implementation fees that are part of the cost of an investment, such as the services in *Case U53* discussed under *Passive investors- implementation fees*, form part of the cost of the investment for trading stock purposes. Unless the accruals rules take precedence, these implementation fees are deductible when incurred pursuant to section BB 7 (b). If the relevant investment is still on hand at year end and the taxpayer, when complying with section EE 1 (3), elects to value at cost price, the implementation fees form part of that cost. Effectively, then the implementation fees are included in assessable income at the end of the year.

Example 3

Investor C is an accountant, employed part-time by a major corporate. Three years ago Investor C inherited a substantial sum of money, which she has put into a wide range of investments. She actively participates in managing her investments. She uses her tax knowledge and accounting expertise to analyse her investments' performances on a regular basis. She engages the service of a financial adviser so that she can obtain independent, objective, third party advice (and to implement her investment strategies).

Although Investor C derives a significant income from her employment as an accountant, the extent and continuity of her investment activities (and her active participation) should be sufficient for Investor C to be considered to be in the business of investing.

Investor C is a business investor and all fees are deductible.

Qualified accruals rules and implementation fees

Some investments are subject to the qualified accruals rules. The qualified accruals rules take precedence over any other rules in the Income Tax Act. The qualified accruals rules have specific provisions for the treatment of implementation fees. These provisions apply to ***all*** investors: passive, speculative, and business investors.

The accruals rules apply to financial arrangements. "Financial arrangement" is a defined term in the Income Tax Act. Broadly, it includes debt instruments, and does not include shares or interests in unit trusts.

Contingent implementation fees

Where implementation fees are contingent on the financial arrangement being implemented, the fees are part of the "acquisition price" of the financial arrangement and as such are subject to the accruals rules. The "acquisition price" is defined to include "the value of all consideration provided by [the investor] in relation to the financial arrangement". Implementation fees paid to financial advisers or other organisations for their services in implementing financial arrangements are provided "in relation to the financial arrangement". See TIB Volume 3, No. 4 (December 1991) at pages 5 and 6.

Category 1: cash basis holders

A cash basis holder is a natural person for whom either the total value of all financial arrangements held by that person will not exceed $600,000, or the income derived in the year by the person from financial arrangements will not exceed $70,000. A further requirement is that the difference between the income that would be returned under the accruals rules, and the income returned as a cash basis holder, does not exceed $20,000.

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An investor who is a cash basis holder returns income and expenditure relating to financial arrangements as and when the income is derived and expenditure incurred. Implementation fees that are part of the acquisition price, however, cannot be taken as a deduction in the year they are incurred. Instead, when the investment matures, is remitted, or is sold the investor will get credit for the fees when he or she performs a "cash base price adjustment".

The cash base price adjustment compares all amounts received by the investor in respect of the investment, with all amounts provided by the investor in relation to the investment. The amounts provided by the investor are the "acquisition price". This calculation will usually mean a comparison of the amount returned at the end of the investment and interest received, with the amounts provided and any direct costs of the investment. If the cash base price adjustment results in a positive amount, the amount is income to the investor. If the cash base price adjustment results in a negative amount, the amount is an allowable deduction.

Because implementation fees are part of the acquisition price, they can be offset against income received from the financial arrangement. This has the effect of allowing a deduction for the fees on the maturity, remission, or sale of a financial arrangement.

Accordingly, if an investor is a "cash basis holder", he or she may deduct implementation fees, irrespective of whether the investor is a passive investor, in the business of investing, or a speculative investor.

Category 2: non-cash basis holders

Where an investor is not a cash basis holder, he or she must return income and expenditure according to the rules set out in section EH 1. Section EH 1 (1) requires that for the purposes of calculating income and expenditure under sections EH 1 (2) to (6), regard must be had to the amount of consideration provided by the person. The accruals rules spread the difference between amounts received by the person and amounts provided by the person over the life of the financial arrangement. Where implementation fees are part of the acquisition price of the arrangement, they will be one of the amounts provided by the person that is spread over the life of the arrangement.

It is not technically accurate to say that the investor gets a deduction for implementation fees, spread over the life of the financial arrangement. Instead, allowing for implementation fees means the investor returns less income over the life of the financial arrangement. This has the same effect as a deduction spread over the life of the financial arrangement.

Non-contingent implementation fees

It is most likely that implementation fees will be contingent on the implementation of a financial plan. However, where implementation fees are not contingent on the implementation of the plan they are covered by specific rules:

- If the non-contingent fees are no more than two percent (2%) of the "core acquisition price", they are excluded from the accruals rules calculations, and their deductibility is tested under normal income tax rules.
- If the non-contingent fees are greater than two percent (2%) of the "core acquisition price", they are included within the accruals rules calculations to the extent that they exceed 2% of the core acquisition price. The remaining amount of fees (that is equal to 2% of the core acquisition price) is deductible or otherwise under normal income tax rules.

Thus for non-contingent fees amounting to 2% or less of the core acquisition price of the financial arrangement, the distinction between passive, business, and speculative investors is important as the normal income tax rules of deductibility are again important.

For non-contingent fees, to the extent that they exceed 2% of the core acquisition price of the financial arrangement, the discussion above relating to contingent fees is relevant.

Example 4

Investor D is a cash basis holder who has invested in a number of financial arrangements on the advice of her financial adviser. Investor D is a passive investor. She paid a fee of 2% of the cost of the financial arrangements as a commission to her adviser. The fee was contingent on the financial arrangements being purchased.

Investor D may not initially deduct the fee. The fee is a contingent fee, and included in the "acquisition price" of the financial arrangement as a direct cost of the investment. As a contingent fee, it is not deductible until a cash base price adjustment is made on the maturity, remission, or sale of the financial arrangement. At that time it will be allowed as an amount provided by the investor, to be offset against amounts received.

If the fee charged was a non-contingent fee, then, to the extent that it was no more than 2% of the core acquisition price of the financial arrangement, it would be excluded from the accruals rules and tested according to normal principles. As such it would be non-deductible as Investor D is a passive investor.

Fees incurred in gaining or producing non-assessable or exempt income

Returns from investments are not assessable to the investor if the investment is taxed before receiving payment from the investment. An example is insurance bonds. Tax is paid on income earned on an insurance bond by the insurance bond fund.

The other situation when returns from investments are not assessable to the investor is where the return is exempt income. Exempt income is provided for in sections CB 1 - CB 15. It will be unusual for investors to derive exempt income from investments.

No deduction is available to the extent to which fees are incurred in the production of non-assessable or exempt income. Section BB 7 only allows a deduction for expenditure incurred in the production of assessable income, or for expenditure necessarily incurred in the carrying on of a business for the purpose of gaining or producing assessable income. Also, section BB 8 (c) denies a deduction for expenditure incurred in gaining exempt income. Therefore, where expenditure on financial planning fees produces non-assessable or exempt income, the fees cannot be deducted.

Example 5

As part of her retirement savings, Investor E makes monthly contributions to a fund manager. The contributions are invested in two funds. One is a tax paid growth fund, that is, no profits or gains are paid to investors. Instead, gains are retained and accumulated until the investor reaches a given age. The other fund returns tax paid receipts to the investor. That is, the fund pays tax on the accumulated income.

Investor E receives no assessable income from her investment. Section BB 8 (c) prohibits the deduction of expenditure or loss incurred in producing exempt income. Therefore, none of the fees incurred are deductible.

The following table is a summary of the income tax treatment of financial planning fees, excluding the impact of the qualified accrual rules on the deductibility of implementation fees.

	- - - - - - - - - - Types of Investors	- - - - - - - - - -	
Fee Type	**Passive**	**Speculative**	**Business**
Planning Fees	Non-deductible	Deductible	Deductible
Implementation Fees	Non-deductible	Deductible	Deductible
Monitoring Fees	Deductible	Deductible	Deductible
Fees incurred in earning exempt income	Non-deductible	Non-deductible	Non-deductible

GST treatment of financial planning fees

Public Ruling - BR Pub 95/11

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation law

This ruling applies in respect of sections 3 and 14 of the Goods and Services Tax Act 1985.

Arrangements to which this ruling applies

This ruling applies to supplies of financial planning services by registered persons. "Financial planning services" means planning services, implementation services, and monitoring services for the purposes of this ruling.

"Planning", "implementation", and "monitoring" services have the following meaning for the purpose of this ruling.

Planning services are the services provided by an adviser when the adviser plans an investor's portfolio of investments. Planning services are often provided at the outset of the portfolio's establishment, but can also be provided as part of the adviser's ongoing service.

Implementation services are the services provided by an adviser when the adviser implements an investor's financial plan. Implementation services also includes the services provided when a custodian implements the plan, and an adviser charges the investor a fee. However, if an adviser's fee in such a situation relates to monitoring services, the services are not implementation services.

Monitoring services are the services provided by an adviser when the adviser monitors and evaluates the performance of an investor's portfolio. Monitoring services include the collection of income from investments, and the exchanging of foreign currency.

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The period for which this ruling applies

This ruling applies to those supplies of financial planning services with a time of supply between period 1 April 1996 to 31 March 1999.

The ruling

Planning services

Planning services supplied in relation to investments are subject to GST. These services are not "financial services" under section 3(1) and 14(a). Because these services are the provision of advice, they are specifically excluded from the definition of "financial services" by section 3(1)(l).

Monitoring services

Monitoring services supplied in relation to investments are subject to GST. These services are not "financial services" under section 3(1) and 14(a). Because these services involve advice, they are specifically excluded from the definition of "financial services" by section 3(1)(l). However, to the extent that a monitoring service involves the collection of income from investments within section 3(1)(ka), or the exchange of currency within section 3(1)(a), the service is an exempt supply of a financial service under sections 3(1) and 14(a).

Implementation services

Implementation services are financial services under section 3(1) and are exempt supplies of financial services under section 14(a). When a custodian implements the plan on the instruction of a financial adviser, any implementation fee charged by the adviser will be exempt under section 3(1)(l) as the arranging of one of the activities in section 3(1)(a) to (ka).

This ruling is signed by me on the 18th day of December 1995.

Martin Smith
General Manager (Adjudication & Rulings)

Analysis of public ruling BR Pub 95/11

This analysis of the ruling does not form part of the ruling.

All legislative references are to the Goods and Services Tax Act 1985.

Background

What are financial planning fees?

Financial advisers charge their clients for services provided to those clients. In the ruling we have broken down these services into three components. Financial advisers may use different names for these component services. The tax treatment of the fees does not depend on the name of the service, but on the nature of the service. To determine the correct tax treatment of a service, it is important to identify the exact service a financial adviser provides.

In the ruling and analysis we use the following terms to refer to the range of services discussed below:

- Planning
- Implementation
- Monitoring.

1. Planning

Planning occurs when the investor seeks detailed advice from the adviser. This service may be provided when the investor contacts the adviser for the first time. The investor and adviser meet to establish the investor's investment requirements and the investor's ability to meet those requirements.

The adviser assesses the investor's current financial position, which may include assessment of investments, savings objectives, cash requirements, and life and general insurance requirements. For corporate or trustee investors, factors assessed may differ.

The adviser then prepares a plan including a range of investment proposals for the investor, and recommends how the investor's goals can best be met.

Planning services may also be provided as part of the financial adviser's on-going service. Using information received from monitoring an investor's portfolio, the financial adviser may recommend changes to the client's investments. The changes may be made to bring the investor's portfolio into line with the client's goals and risk profile, to take advantage of better or new opportunities, or to take into account a change in the investor's requirements. Some financial advisers may call a fee for this service a monitoring fee. However, in this situation this service is better described as a planning fee.

Calculation of the fee charged for planning services varies between advisers. Many advisers charge a flat fee, irrespective of the complexity of the plan. Others charge fees based on the complexity of the plan. The fee may be based on the amount of time spent by the adviser, or it may be a percentage of the funds invested. Some advisers only charge planning fees when the investor adopts the plan.

2. Implementation

Implementation is the service provided when an adviser places investments. Implementation may occur when a financial plan is first implemented, and when investments are later bought and sold.

Often financial advisers use another organisation (a "custodian") to place investments. Advisers will pass on the custodian's implementation charge to the investor, either within their fee, or separately as a disbursement.

Sometimes financial advisers charge investors for initial investments, but not for any later changes to the investments. Other financial advisers do not charge separately for later implementation fees, and instead include charges for changes to investments in a global monitoring fee. A fee is paid for implementation even if it is included in a global fee, and will need to be separately identified for GST purposes.

Implementation fees include fees payable to investment fund managers for entry into the investment.

Some financial advisers charge a large fee when an investment is first made, which equates to the value of a commission otherwise payable to the financial adviser by the fund manager of the investment. The financial adviser may prefer to recover fees from clients rather than through commission from fund managers to remain impartial. The GST treatment of such a charge depends on what services the financial adviser provides. A financial adviser may provide monitoring services for the fee, or may provide implementation services and simply charge the amount he or she would otherwise have received by way of commission as an initial cost.

3. Monitoring

Monitoring involves the adviser monitoring and evaluating the performance of the investor's portfolio. Monitoring services include collecting data on the client's investments, events, and research material that have implications for the investor, and reporting to the investor on this data.

The financial adviser may also evaluate performance of the investment portfolio (which includes performance of fund managers and the adviser) in terms of the investor's goals, and relay this information to the investor.

Monitoring may include arranging the collection of income from investments and exchanging currency.

Monitoring fees are usually charged as a percentage of the investment funds under the adviser's management.

For passive investors, monitoring is typically on an annual or semi-annual basis. For business investors, monitoring may be more regular.

Legislation

GST is imposed on the supply of goods and services in New Zealand (not being an exempt supply) by a registered person in the course of furtherance of a taxable activity, by section 8. Section 14 provides some specific exemptions from GST, including supplies of financial services. Section 3(1) defines the term "financial services" to include:

(a) The exchange of currency (whether effected by the exchange of bank notes or coin, by crediting or debiting accounts, or otherwise):

...

(c) The issue, allotment, drawing, acceptance, endorsement, or transfer of ownership of a debt security:

(d) The issue, allotment, or transfer of ownership of an equity security or a participatory security:

...

(ka) The payment or collection of any amount of interest, principal, dividend, or other amount whatever in respect of any debt security, equity security, participatory security, credit contract, contract of life insurance, superannuation scheme, or futures contract:

(l) Agreeing to do, or arranging, any of the activities specified in paragraphs (a) to (ka) of this subsection, other than advising thereon.

GST implications of financial planning services

The GST implications of the services provided by financial advisers are as follows.

1. Planning

Planning services are subject to GST. They do not constitute financial services under section 3(1) as these services do not involve the adviser making any investments on the taxpayer's behalf within section 3(1)(c) or (d). The service merely involves the adviser in advising the taxpayer on a range of investment opportunities and is, therefore, specifically excluded from the definition of a financial service in section 3(1)(l).

2. Implementation

Implementation services are exempt from GST. The services are provided in relation to the placement of

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investments, which are separate and distinct from monitoring services. The implementation services constitute financial services in terms of section 3(1)(c), (d), and/or (l) and are, therefore, exempt supplies.

In situations where a custodian implements the plan on the instruction of the financial adviser, the fees charged by the adviser to the investor are for an exempt supply of arranging financial services under section 3(1)(l).

If the adviser uses a custodian to place investments and passes on any charges received to the investor as a disbursement, there will be no GST consequences for the adviser if the adviser is acting as the investor's agent. For more discussion on the GST consequences of disbursements refer to *Disbursements by professional firms on behalf of clients - GST* on page 5 of TIB Volume Six, No. 1 (July 1994).

As discussed above under "Background", a financial adviser may charge a large fee when an investment is first implemented. This fee may equate to the value of a commission otherwise payable to the financial adviser by the fund manager of the investment. This fee was described as an implementation fee. The label given to such a supply is not necessarily determinative of the nature of the supply. It is a question of fact what services are provided for the fee, and the services provided will determine the GST treatment.

Where an implementation fee is included as part of an overall supply of monitoring services, the implementation fee is a separate supply which is exempt from GST.

3. Monitoring

Monitoring services are subject to GST, except to the extent discussed below. They do not constitute a financial service under section 3(1). This service involves the adviser evaluating data relating to the investments, evaluating the performance of those investments, and advising the client of the performance. This advice is specifically excluded from the financial services definition by section 3(1)(l).

However, to the extent that the monitoring service involves the collection of income from investments, or the exchanging of currency, or the arranging of the same, the service is an exempt supply under section 3(1)(a), (ka), and/or (l). Therefore, the fee will be partly exempt and partly taxable. Section 10(18) requires an apportionment of the fee between taxable and exempt supplies: *CIR v Smiths City Group Limited* (1992) 14 NZTC 9,140.

Examples

These examples do not form part of the ruling.

Example 1

Financial Adviser prepares a plan for Investor. Financial Adviser charges Investor $2,000 for the plan. Investor decides to implement the plan and asks Financial Adviser to arrange with Custodian to implement the plan. Financial Adviser asks, on Investor's behalf and as Investor's agent, for Custodian to implement the plan. Custodian's fee is charged to Investor by an invoice sent to Financial Adviser. Financial Adviser passes the invoice on to Investor. Custodian's fee is $1,500, which is in addition to the $2,000 charged by Financial Adviser.

The $2,000 Financial Adviser charges Investor is for a taxable supply of planning services. The advice falls within the advising exclusion in paragraph (l) of the definition of "financial services". Financial Adviser must account for GST output tax on the supply.

There are no GST implications for Financial Adviser for passing on Custodian's invoice to Investor, because Financial Adviser is simply the agent of Investor. Custodian's services are exempt supplies of implementation services and no GST output tax needs to be returned by Custodian.

Example 2

Six months after implementing the plan, Financial Adviser passes on to Investor dividend income collected on Investor's behalf. Financial Adviser also conducts a review of the investment portfolio. Financial Adviser charges a small commission of $50 for collecting the dividend income and $250 for the review. Both sums are invoiced as monitoring services.

The $50 charge for collecting dividends is consideration for an exempt supply under section 3(1)(ka). Financial Adviser does not need to return GST on the amount. The $250 for the plan review is a monitoring service and as such is subject to GST. Financial Adviser must return GST output tax on this amount.

GST: importers and input tax deductions

Public Ruling - BR Pub 95/9

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation law

This ruling applies in respect of section 20 of the Goods and Services Tax Act 1985.

Arrangements to which this ruling applies

This ruling applies when registered persons seek to claim input tax deductions for GST levied by New Zealand Customs on goods they have imported into New Zealand for the purposes of making taxable supplies.

The period for which this ruling applies

This ruling applies to claims for input tax deductions for GST levied by New Zealand Customs on goods imported into New Zealand between 1 February 1996 and 31 January 1999.

The ruling

A registered person may use either a Customs Import Entry Form or a Deferred Payment of Duty Statement to support a claim for a GST input tax deduction under section 20 for GST levied by New Zealand Customs on goods imported into New Zealand.

This ruling is signed by me on the thirteenth day of December 1995.

Martin Smith
General Manager (Adjudication & Rulings)

Analysis of public ruling BR Pub 95/9

This analysis of the ruling does not form part of the ruling.

The subject matter of this ruling was previously considered at page 7 of TIB Volume 4, No.1 (August 1992) in an item *GST and Non-Resident Importers*. This ruling replaces the part of that item titled *Documentation Required by an Importer to Support an Input Tax Deduction*, pp. 8-9.

All legislative references are to the Goods and Services Tax Act 1985.

Background

The Court of Appeal in *Shell New Zealand Holding Co Ltd v CIR* (1994) 16 NZTC 11,163 considered when a registered person could claim an input tax deduction on receiving both an Import Entry Form and a Deferred Payment of Duty Statement. It concluded that an Import Entry Form was an “invoice” for the purposes of the GST Act and that a person may use that document to support a claim for an input tax deduction, even when the person had also received a Deferred Payment of Duty Statement.

Legislation

Section 2

“Invoice” means:

... a document notifying an obligation to make payment.

“Input tax” in relation to a registered person means:

...

(b) Tax levied under section 12(1) or section 13(1) of this Act on goods entered for home consumption under the Customs Act 1966 by that person:

Section 12

(1) Notwithstanding anything in this Act, a tax to be known as good and services tax shall be levied, collected, and paid in accordance with the provisions of this section at the rate of 12.5 percent on the importation of goods (not being fine metal) into New Zealand, being goods that are -

(a) Entered therein, or delivered, for home consumption on or after the 1st day of October 1986 under the Customs Act 1966; or

(aa) Entered for delivery to a manufacturing area under the Customs Act 1966; or

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(b) Before their entry, or delivery, for home consumption or, as the case may be, entry for delivery to a manufacturing area under the Customs Act 1966, dealt with on or after the 1st day of October 1986 in breach of any provision of any of the Customs Acts, -

by reference to the value of the goods as determined under subsection (2) of this section.

...

(3) Subject to this section, tax levied under subsection (1) of this section shall be collected and paid as if it were Customs duty levied on the importation of goods under the Customs Act 1966, and as if all goods imported into New Zealand were liable to Customs duty.

Section 20(3)

Subject to this section, in calculating the amount of tax payable in respect of each taxable period, there shall be deducted from the amount of output tax of a registered person attributable to the taxable period -

(a) In the case of a registered person who is required to account for tax payable on an invoice basis pursuant to section 19 of this Act, the amount of input tax -

...

(ii) Invoiced or paid, whichever is the earlier, pursuant to section 12 or section 13 of this Act during that taxable period.

Provided that where any registered person is entitled, pursuant to the foregoing provisions of this subsection, to deduct any amount in respect of any taxable period from the amount of output tax attributable to that taxable period, the registered person may deduct that amount from the amount of output tax attributable to any later taxable period to the extent that it has not previously been deducted from the output tax of that registered person.

Application of legislation

The Act permits importers to claim an input tax deduction for the GST levied by the New Zealand Customs Department on goods imported into New Zealand. Unlike other claims for input tax deductions, the Act only requires the importers to hold invoices to support their claims rather than tax invoices. This is because the New Zealand Customs Department does not make any supplies when it is levying GST on goods imported into New Zealand. It is, therefore, not required to issue tax invoices under section 24. The question then arises as to which documents (the Deferred Payment of Duty Statement or the Customs Import Entry Form) issued by the New Zealand Customs Department are “invoices” for the purposes of the GST Act.

The New Zealand Customs Department issues a Customs Import Entry Form at the time that the goods are imported into New Zealand. This document names the importer, describes the goods imported, and quantifies the amount of duty and GST due.

The New Zealand Customs Department also operates an optional deferred payment scheme for importers, under which it issues a Deferred Payment of Duty Statement for the duty owed by importers on all the goods they have imported during that month. The Deferred Payment of Duty Statement is created from the information contained in the Customs Import Entry Forms.

The Court of Appeal in *Shell New Zealand Holding Co Ltd v CIR* considered the issue of when an importer could claim an input tax deduction for the GST levied on goods imported into New Zealand. It concluded that the Customs Import Entry Form notified the importer of an obligation to make payment, as it stated the total duty, total GST, and total payable. Therefore, the Customs Import Entry Form fell within the GST definition of “invoice”.

The *Shell* decision confirms that an importer may use a Customs Import Entry Form to support a claim for a GST input tax deduction.

Example

This example does not form part of the ruling.

Mary imports and sells European cars. She is registered for GST, accounts for tax payable on an invoice basis, and files GST returns on a two-monthly basis. Mary imports cars worth $300,000 on 28 September. She completes an Import Entry Form listing the cars she has imported and their values. The Import Entry Form also states the total duty, total GST, and total amount payable on the importation of those cars. The New Zealand Customs Department signs and stamps the Import Entry Form on 28 September.

Mary receives a Deferred Payment Statement on 23 November. This statement lists all the goods she has imported for the period 23 September to 23 November, and states the total amount of duty and GST that she has to pay.

Mary’s taxable period ends on the last day of September. She is required to furnish her GST return for the months of August and September, stating the amount of tax she has to pay for those two months. Mary will include in her GST return for that taxable period the GST levied on the imported cars.

Mary only needs an invoice to substantiate her claim for an input tax deduction for the GST that New Zealand Customs has levied on the imported cars. Mary may claim the input deduction in the taxable period ending in September because the Import Entry Form contains all the necessary details to be an invoice for the purposes of the GST Act.

GST and supplies paid for in foreign currency

Public Ruling - BR Pub 95/12

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation law

This ruling applies in respect of sections 2(1) (definition of "money"), 3(1) (definition of "financial services"), 10(2), 14(a), and 77 of the Goods and Services Tax Act 1985.

Arrangements to which this ruling applies

This ruling applies when a registered person accepts payment for a taxable supply of goods or services in a foreign currency, where that supply is made in New Zealand.

The period for which this ruling applies

This ruling applies to taxable supplies of goods and services where payment is made in foreign currency, where the time of supply occurs within the period from 1 March 1996 to 28 February 1999.

The ruling

When the consideration for a taxable supply of goods and services is paid in foreign currency, the value of the taxable supply is the amount of foreign currency converted to New Zealand currency at the exchange rate applying at the time of supply.

The Commissioner will accept as the appropriate exchange rate the rate offered by registered banks or bureaux de change.

This ruling is signed by me on the 19th day of December 1995.

Martin Smith
General Manager (Adjudication & Rulings)

Analysis of public ruling BR Pub 95/12

This analysis of the ruling does not form part of the ruling.

All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.

Background

A number of registered persons, particularly those involved in tourism, accept foreign currency as payment for supplies of goods and services. Often a registered person will offer the customer an "in-house" exchange rate. This exchange rate is less favourable to the customer than other exchange rates. That is, the customer gets less New Zealand currency for the foreign currency than that obtainable at a bank or a bureau de change.

The registered supplier will exchange the foreign currency at a bank and receive New Zealand currency. Because the bank exchange rate is better than the exchange rate the registered person gave the customer, the registered person will make a profit on the conversion of the foreign currency. The Commissioner has been asked to consider the GST treatment of such a profit. In particular, the Commissioner has been asked whether the profit is consideration for an exempt supply, or whether the profit is part of the consideration for a taxable supply.

Legislation

Section 2(1) defines "money":

"Money" includes-

(a) Bank notes and other currency, being any negotiable instruments used or circulated, or intended for use or circulation, as currency; and

(b) Postal notes and money orders; and

(c) Promissory notes and bills of exchange,-

whether of New Zealand or any other country, but does not include a collector's piece, investment article, or item of numismatic interest.

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Section 3(1) defines "financial services". Under paragraph (a):

For the purposes of this Act, the term "financial services" means any one or more of the following activities:

(a) The exchange of currency (whether effected by the exchange of bank notes or coin, by crediting or debiting accounts, or otherwise)...

Section 14(a) exempts supplies of financial services from GST.

Section 10 is the section providing for the value of supply. Section 10(2) states:

Subject to this section, the value of a supply of goods and services shall be such amount as, with the addition of the tax charged, is equal to the aggregate of,-

(a) To the extent that the consideration for the supply is consideration in money, the amount of the money:

Section 77 states:

For the purposes of this Act, all amounts of money shall be expressed in terms of New Zealand currency, and in any case where and to the extent that such amount is consideration in money for a supply, that amount shall be expressed in terms of New Zealand currency as at the time of that supply.

Application of legislation

Number of supplies

When a registered person sells goods and services to a customer who pays in foreign currency, there is only one supply. That supply is the supply of goods and services. There has been some confusion over the classification of supplies in these circumstances, and a suggestion that there are two supplies. The first supply being a supply of goods and services and the second supply being an exempt supply of the exchange of currency (under section 3(1)(a) and section 14(a)). It will be a question of fact in each case whether there are one or two supplies. In the ordinary commercial situation there will be no reconstruction of the transaction to recharacterise two supplies as one or vice versa, nor is it appropriate to apply principles of economic equivalence to achieve similar results between one supply and two supply situations.

When a registered person accepts foreign currency in payment for supplies, there is no exempt supply of the exchange of currency. To be an exchange of currency under section 3(1)(a) one currency must be exchanged for another. Section 3(1)(a) does not cover the situation when currency is exchanged for goods and services. The fact that the registered person will later exchange the currency with a bank or bureau de change does not alter this. The transaction between the registered person and the bank or bureau de change involves an exempt supply of the exchange of currency by the bank or bureau de change to the registered person. There is no such exempt supply from the registered person to the customer.

In situations where there is only one supply, a supply of goods and services, the value of supply is important, particularly since the registered person usually makes a profit from the low exchange rate.

Value of supply

When a registered person sells goods and services to a customer, the value of supply is determined using the rules in section 10. Under section 10(2)(a), when consideration for the supply is an amount of money, the value of supply is the amount of money. "Money" is defined in section 2(1) and includes foreign currency.

Therefore, when a customer tenders foreign currency as consideration for a supply, the value of supply is the amount of foreign currency. However, section 77 requires all amounts of money tendered in consideration of a supply to be "expressed in terms of New Zealand currency as at the time of that supply".

"Expressed in terms of New Zealand currency"

There are three possible interpretations of the phrase "all amounts of money shall be expressed in terms of New Zealand currency". It could mean that:

- The parties must state their transaction, or document it, in New Zealand currency and the supplier return that amount for GST purposes; or
- The supplier must convert foreign currency to New Zealand currency at the current market exchange rate and return that amount for GST purposes; or
- The supplier may convert foreign currency to New Zealand currency at the rate agreed between the parties and return that amount for GST purposes.

The first interpretation does not require any type of conversion, whereas the second and third do. The Income Tax Act 1994 uses the phrase (or variants) at least twice. Section CF 2 (12)(a)(i) states:

For the purposes of subsection (11), in respect of determining whether and the extent to which the making available of any property (being a loan) by any person (in this subsection referred to as the "company'') to any person (in this subsection referred to as the "shareholder'') gives rise to a dividend-

(a) In relation to any quarter the rate of interest specified shall be-

(i) In the case of any loan where all amounts payable to the company in relation to the loan are **expressed in New Zealand currency** and- [Emphasis added.]

This provision does not assist in interpreting section 77 as the reference is clearly to a factual state of affairs, namely whether or not a loan is in New Zealand currency or not.

Section KF 2 (5) (definition of "effective rate of domestic income tax") states:

"Effective rate of domestic income tax", in relation to a company that is not resident in New Zealand and to an accounting year of that company, means the rate ascertained in accordance with the following formula:

$$\frac{a}{b}$$

where-

a is the total income tax (**expressed in terms of New Zealand currency** at the rate of exchange in force on the last day of that accounting year) payable by that company in the country or territory in which it is resident, in respect of the total income derived by it in that accounting year, being the total income upon which the total income tax is levied; and

b is that total income (expressed in terms of New Zealand currency at the rate of exchange in force on the last day of that accounting year): [Emphasis added.]

This definition is an equivalent use of the phrase in section 77, and supports the interpretation that the phrase requires some type of conversion. Accordingly, there is support for the second and third interpretations, but not the first.

The words in section 77 are exactly equivalent to those in section 20(1) of the Australian Income Tax Assessment Act 1936. Section 20(1) has been accepted as embodying the decision of the Privy Council in *Payne v Deputy FCT* [1936] 2 All ER 793 (see, for example, Dixon J in *Adelaide Electric Supply Co Ltd v FCT* (1949) 78 CLR 557). In the *Payne* decision, Lord Russell said at page 796 of the judgment:

...the assessable income of the taxpayer must, whatever be the currency in which he derives it, all be **expressed in terms of Australian currency; in other words** if any portion of his assessable income is derived by him in French or Belgian currency, **it must before he can be properly assessed to Australian income tax be converted into its equivalent, at the time it was derived, in Australian currency**. In exactly the same way, any income derived by him in British currency must be converted into its equivalent in Australian currency. In short when an Australian statute tells the taxpayer to state his derived income in order that a fraction thereof (i.e., so many pence in the pound of derived income) may be taken as tax, this can only mean that his derived income is to be stated and dealt with in terms of Australian currency. From this it would accordingly follow that the commissioner was right in including the amount of £1,097 in the appellant's assessment. [Emphasis added.]

Lord Russell was using the words subsequently adopted in section 20(1) in the sense described above in the second interpretation. Accordingly, the second interpretation of the phrase in section 77 is to be preferred to the first and third interpretations. That is, the phrase "expressed in terms of New Zealand currency" in section 77 requires the amount of foreign currency tendered as consideration for a supply to be converted into an amount of New Zealand currency at the exchange rate applying at the time of supply. The Commissioner will accept the exchange rates offered by a registered bank or a bureau de change.

The Commissioner will accept the bank exchange rates of ASB Bank, ANZ/Postbank, BNZ, Countrywide, National Bank, Trustbank, or Westpac. The Commissioner will accept the bureau de change exchange rates of Thomas Cook or American Express.

The value of supply is not the value of foreign currency tendered as consideration exchanged at the registered person's low exchange rate. Instead, it is the value of foreign currency tendered as consideration converted at the exchange rate determined by the registered banks and bureaux de change operating in the foreign exchange markets.

Examples

These examples do not form part of the ruling.

Example 1

Hotel Guest wishes to exchange some foreign currency for New Zealand currency. Hotel offers him a low exchange rate which he accepts. Hotel exchanges the foreign currency at a bank and makes a small profit.

The profit is consideration for an exempt supply, being the exempt supply of an exchange of currency. Hotel has exchanged New Zealand currency for foreign currency. The consideration for the supply is the difference between the exchange rate Hotel receives from the bank, and the exchange rate Hotel gave Hotel Guest.

For example:

Approved exchange rate:	NZ$1 = Foreign$3 or Foreign$1 = NZ$0.33
Hotel exchange rate:	NZ$1=Foreign$4 or Foreign$1=NZ$0.25

Hotel Guest exchanges Foreign$300 at Hotel exchange rate, and receives NZ$75. Hotel exchanges the Foreign$300 at the bank for the approved exchange rate and receives NZ$100. The NZ$25 profit is consideration for an exempt supply and is not subject to GST.

Example 2

Hotel Guest checks out of Hotel and settles his bill using Foreign currency. Again Hotel offers him a low exchange rate which he accepts. Hotel exchanges the money at a bank and makes a small profit.

The profit on the currency exchange at the bank is part of the consideration for the taxable supply of goods and services by Hotel to Hotel Guest. The value of supply is the amount of foreign currency tendered in consideration for the supply. As the amount of money is foreign currency, it needs to be expressed in amounts of New Zealand currency. That change to New Zealand currency should take place at the approved exchange rate. That means the profit on the currency exchange is part of the consideration for the taxable supply Hotel makes.

For example:

Exchange rates as above. Bill of NZ$1,000. Hotel Guest tenders Foreign$4,000 to pay the bill. Hotel accepts the Foreign$4,000 in full payment of the bill, at Hotel's exchange rate. Hotel then exchanges the Foreign$4,000 at the bank for the approved exchange rate and receives NZ$1,333, making a profit of $333 on the currency. This profit is part of the consideration for a taxable supply and is subject to GST.

Legislation and determinations

This section of the TIB covers items such as recent tax legislation, accrual and depreciation determinations, livestock values and changes in FBT and GST interest rates.

Propane gas cylinders - depreciation

It has been brought to our attention that the estimated useful life and rates determined in Determination DEP1: Tax Depreciation Rates General Determination Number 1 for the asset class "Gas Cylinders" may not be correct for propane gas cylinders. This asset class currently appears in three Industry Categories:

- Engineering (including automotive),
- Hotels, Motels, Restaurants, Cafes, Taverns and Takeaway Bars
- Oil and Gas Industry.

The following details appear in all three categories:

Estimated Useful Life (years)	5
DV banded depn rate (%)	33
SL equiv banded depn rate (%)	24

We propose to create a new asset class in all three categories called "Propane Gas Cylinders" with the following details:

Estimated Useful Life (years)	20
DV banded depn rate (%)	9.5
SL equiv banded depn rate (%)	6.5

If you wish to make submissions on this proposed change please write to:

Manager
Rulings Directorate
National Office
Inland Revenue Department
PO Box 2198
WELLINGTON

Please send any submissions by 1 March 1996.

FBT - prescribed interest rate remains at 10.6%

The prescribed interest rate used to calculate the fringe benefit value of low interest employment-related loans remains at 10.6% for the quarter that started on 1 October 1995. This rate will also apply to subsequent quarters until any further adjustment is made.

Student Loan scheme - interest rates and repayment threshold for 1996-97

On 6 December 1995 the Minister of Education announced the interest rates and the repayment threshold for the Student Loan scheme for the year starting on 1 April 1996.

The total interest rate will be 8.4 percent. This is made up of the base interest rate of 6.2 percent and the interest adjustment rate of 2.2 percent.

The repayment threshold for the 1996-97 income year will be $14,300

Policy statements

This section of the TIB contains policy statements issued by the Commissioner of Inland Revenue. Generally, these statements cover matters on which Inland Revenue wishes to state a policy, but which are not suitable topics for public binding rulings.

In most cases Inland Revenue will assess taxpayers in line with the following policy statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of assessment we consider that the earlier advice does not follow the law.

Reopening income tax assessments

Summary

This item discusses section MD 1 of the Income Tax Act 1994 and the reopening of income tax assessments.

Some taxpayers have suggested that the Commissioner can use section MD 1 to reopen income tax assessments. This is not correct. Section 113 of the Tax Administration Act 1994 is the correct provision under which the Commissioner may reopen an income tax assessment. Section MD 1 is merely an administrative provision which provides for the payment of refunds, and which imposes an eight-year time limit for income tax refunds following the reopening of an assessment.

All legislative references in this item are to the Tax Administration Act 1994 unless otherwise indicated.

Legislation

Cross-reference table

Income Tax Act 1994	**Income Tax Act 1976**
MD 1	409
Tax Administration Act 1994	**Income Tax Act 1976**
108	25
113	23

Section MD 1 of the Income Tax Act 1994 provides for refunds of overpaid tax. Under the proviso to section MD 1 (1), in most cases payment of a refund must be made within eight years after the end of the year in which the assessment was made, unless written application for the refund is made by or on behalf of the taxpayer before the expiration of the eight-year period. Section MD 1 (1) states:

Subject to sections MD 2, MD 3, and NH 4, in any case where the Commissioner is satisfied that tax has been paid in excess of the amount properly payable, the Commissioner shall refund the amount paid in excess:

Provided that, subject to subsection (2), no refund shall be made under this section after the expiration of the period of 8 years immediately after the end of the year in which the assessment was made or, in any case where the original assessment has been altered (whether once or more than once), after the end of the year in which the original assessment was made, unless written application for the refund is made by or on behalf of the taxpayer before the expiration of that period.

Section MD 1 (2) deals with the situation when excessive tax has been paid as the result of the alteration of an assessment.

The Commissioner may alter assessments to ensure that the correct amount of tax is paid. Section 113 states that:

(1) The Commissioner may from time to time and at any time make all such alterations in or additions to an assessment as the Commissioner thinks necessary in order to ensure its correctness, notwithstanding that tax already assessed may have been paid.

(2) If any such alteration or addition has the effect of imposing any fresh liability or increasing any existing liability, notice of it shall be given by the Commissioner to the taxpayer affected.

The Commissioner's power to amend assessments is limited by section 108 which states that:

(1) When any person has made returns and has been assessed for income tax for any year, it shall not be lawful for the Commissioner to alter the assessment so as to increase its amount after the expiration of 4 years from the end of the year in which the notice of original assessment was issued.

(2) Notwithstanding subsection (1), in any case where, in the opinion of the Commissioner, the returns so made are fraudulent or wilfully misleading or omit all mention of income which is of a particular nature or was derived from a particular source, and in respect of which a return is required to be made, it shall be lawful for the Commissioner to alter the assessment (being an assessment made on or after 1 April 1958) at any time so as to increase the amount of the assessment.

Application of legislation

Assessments may be reopened under section 113. Section 108 limits this power so that assessments cannot be increased after four years from the end of the year in which the Commissioner issued the notice of original assessment. However, if the returns were fraudulent, wilfully misleading, or omitted all mention of income of a particular nature or from a particular source, the Commissioner can alter the assessments at any time.

Section MD 1 of the Income Tax Act relates to the refund of overpaid tax. It does not provide a means of reopening an assessment. However, if the Commissioner alters an assessment under section 113, the Commissioner would pay any refund pursuant to section MD 1.

PAYE and earner premium deductions - penalties for failure to make or account for deductions

Introduction

This item sets out the penalties an employer can be liable for under the Tax Administration Act 1994 (TAA) and the Income Tax Act 1994 (ITA), for failing to make or failing to account for PAYE and earner premium deductions.

All legislative references in this item are to the Tax Administration Act 1994 unless otherwise indicated.

Background

Section NC 2 (1) of the ITA requires employers to make tax deductions from source deduction payments that they make to employees.

Employers are also required under section 115 of the Accident Rehabilitation and Compensation Insurance Act 1992 (ARCI Act) to collect earner premiums on behalf of the Accident Rehabilitation and Compensation Insurance Corporation, by deducting earner premiums from any source deduction payment made to an employee.

Earner premiums have been incorporated into the PAYE deduction tables and are deducted along with the tax deduction required to be made under the PAYE rules.

The TAA draws a distinction between:

- an employer failing to make combined tax and earner premium deductions; and
- an employer failing to account for combined tax and earner premium deductions.

Failing to deduct tax and earner premium

This occurs when an employer pays the gross amount of salary or wages to an employee without making the proper combined tax and earner premium deduction. An employer can fail to deduct either all or part of the required deduction.

Examples of failure to deduct are:

- making no deductions at all
- making a partial deduction
- using the wrong tax rate.

Failing to account for tax and earner premium deductions

This occurs when an employer pays the net amount of the source deduction payment to an employee, but fails to pay the combined tax and earner premium deduction to Inland Revenue by the due dates prescribed in section NC 15 of the ITA.

Examples of failure to account are:

- tax and earner premium deduction payment not received by Inland Revenue
- tax and earner premium deduction received by Inland Revenue late
- tax and earner premium deduction received on time but cheque dishonoured.

If the due date falls on a weekend or public holiday, no penalty is levied if payment is made on the next business day.

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
NC 2	338
NC 15	353
OB 1	2
Tax Administration Act 1994	**Income Tax Act 1976**
140	370
194	369
206	368
222	416B
223	427

An employer who either fails to make or fails to account for combined tax and earner premium deductions may be liable to certain penalties under the TAA and/or the ITA.

Section OB 1 of the ITA defines a "combined tax and earner premium deduction" for any source deduction payment, as the total of:

(a) The tax deduction required to be made under the PAYE rules from the source deduction payment; and

(b) The deduction required to be made from that source deduction payment under section 115 of the Accident Rehabilitation and Compensation Insurance Act 1992 on account of the earner's premium payable by employees under that Act.

An employer who fails to make combined tax and earner premium deductions is liable for a 10% late payment penalty under section 140. It may also be liable for the following:

- prosecution in the District Court under section 206
- penal tax of up to treble the amount in default under section 194
- publication of name in the Gazette.

Imposition of 10% penalty

Under sections 140(1)(d) - (f), employers who fail to make or fail to account for combined tax and earner premium deductions are liable to pay a 10% penalty calculated on the amount of the unpaid tax and earner premium. Section 140(1) states:

(d) 10% of the amount in respect of which default has been made (that amount being referred to in this subsection as the “amount in default”); and

(e) 10% of the amount of so much, if any, of the amount in default and the penalty added to that amount in accordance with paragraph (d) as remains unpaid at the expiry of the day on which there expires the period of 6 months immediately following the day on which the failure occurred; and

(f) 10% of the amount of so much, if any, of the amount in default and the penalty added to that amount in accordance with paragraphs (d) and (e), and of the penalty, if any, previously added in accordance with this paragraph, as remains unpaid at the expiry of any of the periods of 6 months that, consecutively, succeed the period of 6 months referred to in paragraph (e).

An employer is liable to pay a 10% penalty even though it is not convicted of the offences of failing to make a deduction or failing to account under section 206.

Under section 182(1), after receiving a written application the Commissioner may remit or refund (if already paid) all or part of the 10% incremental penalty imposed under section 140, if having regard to the circumstances of the case, he thinks it would be equitable to do so. The Commissioner’s policy when considering applications made under section 182(1) is set out in Tax Information Bulletin Volume Seven, No.5 (November 1995).

Fines payable if convicted of an offence under section 206

It is an offence under section 206 for an employer to fail to make a deduction or to fail to account for combined tax and earner premium deductions. Any prosecution action taken by the Commissioner will be in the District Court.

Under section 206(2), an employer is deemed to have made a combined tax and earner premium deduction if and when the employer makes a ***net*** source deduction payment.

Section 206(2) also states that the amount of the deduction is deemed to have been applied for a purpose other than its payment to the Commissioner, if the payment of the deduction is not paid to the Commissioner within the prescribed time.

However, under the proviso to section 206(2), an employer will not be convicted of an offence under section 206 if:

... the person satisfies the Court that the amount of the deduction has been accounted for, and that the person’s failure to account for it within the prescribed time was due to illness, accident, or other cause beyond the person’s control.

Section 222(1) sets out the maximum fines or terms of imprisonment that may be levied for a conviction under section 206. It states:

(a) On the first occasion on which that person is convicted of any such offence or more than one such offence, be liable, in respect of that offence or, as the case may be, each of those offences, to imprisonment for a term not exceeding 12 months or to a fine not exceeding $15,000:

(b) On every occasion, other than the occasion referred to in paragraph (a), on which that person is convicted of any such offence or more than one such offence, be liable, in respect of that offence or, as the case may be, each of those offences, to imprisonment for a term not exceeding 12 months or to a fine not exceeding $25,000.

Imposition of penal tax

In addition to the above penalties, under section 194 penal tax of up to three times the amount of unpaid tax is chargeable.

Publication of name in the Gazette

Under section 223, the name of any person who has been convicted in court for tax evasion, failed to deduct or account for combined tax and earner premium deductions, or who has been charged penal tax, will be published in the Gazette. These names may also be published in local newspapers.

However, the Commissioner has a discretion under section 223 to omit the name of any such person, if he is satisfied that the taxpayer in question voluntarily disclosed complete information and provided full particulars prior to any investigation or inquiry commencing.

***Example** - Calculation of late payment penalty*

Ted Crossit Limited is an employer that must pay combined tax and earner premium deductions to Inland Revenue on a monthly basis. A combined tax and earner premium deduction of $1,263.45 is due 20 July 1994.

Ted Crossit Limited makes payment of $700 only on 4 August. Penalties are charged as follows:

Combined tax and earner premium deduction due 20 July	$1,263.45
Plus 10% penalty	$ 126.34
	$1,389.79
Less amount paid 4 August	$ 700.00
Combined tax and earner premium deduction outstanding as at 20 Jan 1995	$ 689.79
Plus 10% penalty	$ 68.97
	$ 758.76

A further 10% penalty will be charged on the balance outstanding at the expiry of every consecutive six-monthly period.

Change to payment due date set under section 139(4), Tax Administration Act 1994

Summary

Under section 139(4) of the Tax Administration Act 1994, when an assessment is made which increases tax payable after the due date for paying the tax, the Commissioner shall fix a new due date for paying that tax. The section does not apply if the taxpayer has been guilty of neglect or default in making due and complete returns.

Section 139(4) does not specify when the new due date should be. Inland Revenue's policy has been to set the date one month from the 7th of the month following the date of the assessment.

We have now amended this policy. From 1 October 1995 the due date for payment is two months from the date of assessment, the date that coincides with the last date for making an objection. The change in policy applies to assessments of revenues which are subject to section 139(4), such as income tax, FBT etc. It does not include revenues which are subject to other provisions in other Acts such as GST and Child Support. The Goods and Services Tax Act 1985 sets a new due date one month from the date of assessment while the Child Support Act 1991 sets a new due date 30 days from the date of the assessment. The two month period applies to all revenues that are subject to section 139(4) excluding PAYE and Resident Withholding Tax for which work on the systems changes is continuing.

We have made another policy change to make it clear that the objection period for all revenues collected under the Income Tax Act 1994 is two months from the date of the assessment. There was previously some confusion about some revenues such as FBT.

Background

Inland Revenue received a number of submissions about the due date for payment when tax has been reassessed and the charging of additional tax when we have received a competent objection. It was possible to be charged additional tax on what was to subsequently become deferrable tax because the due date for payment was before the last day for making an objection.

Legislation

Cross-reference Table

Tax Administration Act 1994	Income Tax Act 1976
139(4)	398(5)

Section 139(4) of the Tax Administration Act 1994 states:

In any case in which an assessment is not made until after the due date of the tax, or is increased after the due date of the tax, and the Commissioner is satisfied that the taxpayer has not been guilty of neglect or default in making due and complete returns for the purposes of that tax, the Commissioner shall in the Commissioner's notice to the taxpayer of the assessment or amended assessment, or in any subsequent notice, fix a new due date for the payment of the tax or of the increase, and the date so fixed shall be deemed to be the due date of that tax or increase for the purposes of subsection (1) or subsection (3).

Provided that this subsection shall not apply in relation to any assessment made under section EH 6(5) of the Income Tax Act 1994.

Comment

Before we extended the period in which to make an objection from one month to two months there was no problem with the due date for the payment of tax falling before the last day to make an objection. When setting a new due date it was set one month from the seventh of the month after the assessment was issued, which was always after the expiry of the time in which to make an objection. However with the change to the two month objection period this changed.

We also considered that the system of setting due dates was not equitable. The time allowed to pay was dependent upon what day of the month the assessment was issued, and could be anywhere from one month plus one day to one month plus 30 days. Because of this factor we decided to change the due date for payment to two months from the date of assessment. There is also a compliance saving in that is that there is only one date for the taxpayer/agent to focus on rather than two.

Policy

From 1 October 1995 the due date for payment of tax set under section 139(4) of the Tax Administration Act 1994 when an assessment is issued will be two months from the date of that assessment, when the assessment is not made until after the original due date for payment of that tax. This will apply as long as the Commissioner is satisfied that the taxpayer has not been guilty of neglect or default in making due or complete returns and the tax assessed is more than that calculated by the taxpayer. As a matter of clarification the objection period for all revenues collected under the Income Tax Act 1994 is two months.

This applies to all revenues that are subject to section 139(4) excluding PAYE and Resident Withholding Tax, for which work on the systems changes is continuing. Once these changes have been made the policy will be extended to these revenues.

Mining assets - deductibility/assessability

Summary

This item sets out the Commissioner's current policy for the acquisition of an asset by a mining company, and its treatment under section DN 1. It appears that some taxpayers are under the impression that by not claiming a deduction under section DN 1 (7) they will not be assessed on the income from the sale of the asset under section DN 1 (11). The Commissioner considers that this is not correct. Although he has the discretion to allow a deduction, on the sale of that asset the sale proceeds will be treated as assessable income whether or not a deduction has been claimed.

All references in this item are to the Income Tax Act 1994 unless otherwise stated.

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
DN 1 (1)	216(1)
DN 1 (2)	216(2)
DN 1 (7)	216(8)
DN 1 (11)	216(12)
DN 1 (12)	216(13)
OB 1 "specified mineral"	215(1)

Under section DN 1 (1), section DN 1 will apply notwithstanding anything in the Act.

Under section DN 1 (2), the section is to apply to any New Zealand company (defined in section OB 1 as a company incorporated in New Zealand) as long as the Commissioner is satisfied that one of the following applies:

- The company's sole or principal source of income is the business of mining in New Zealand any specified mineral.
- The company carries on, or proposes to carry on, in New Zealand, as its sole or principal undertaking, exploring or searching for or mining any specified mineral, or performing development work in relation to the exploring or searching or mining. This does not apply to activities carried on or proposed to be carried on as a service to any other person for reward, unless the Commissioner is satisfied that the reward is solely or principally related to and dependent upon the production of that specified mineral or by way of participation in profits from the production of that specified mineral.

Section OB 1 defines a "specified mineral" as being any one of the following minerals:

(a) Alumina minerals (such as bauxite, gibbsite, diaspore, and corundum), aluminous refractory clays and fireclays containing in either case over 30% alumina in the fired state, andalusite, antimony, asbestos, barite, bentonite (other than bentonite mined in the county of Malvern), bituminous shale, chromite, copper, diatomite, dolomite, feldspar, fluorite, gold, halloysite, kaolin, kyanite, lead, magnesite, manganese, mercury, mica, molybdenite, nickel, perlite, phosphate, platinum group, pyrite, silica in lump form used only in the production of silicon carbide, silicon metal, or ferro silicon, silica in sand form used only in the production of silicon carbide, sillimanite, silver, sodium chloride, sulphur, talc, tin, titanium, titanomagnetite, tungsten, uranium, wollastonite, zeolite, zinc, or zircon:

(b) Any other mineral which -

(i) In the opinion of the Minister is or will be of importance -

(A) In the industrial development of New Zealand; or

(B) As a means of reducing the quantity of industrial minerals or industrial rock required to be imported into New Zealand; or

(C) As an item of export from New Zealand; and

(ii) Is declared by the Minister by notice in the Gazette to be a specified mineral for the purposes of this definition.

Under section DN 1 (7), in a year that a mining company has incurred any exploration or development expenditure, whether or not on the acquisition of an asset, the Commissioner may allow a deduction for that expenditure in that year.

Under section DN 1 (11), when a mining company has acquired any asset as a result of any exploration expenditure or development expenditure and the company subsequently disposes of that asset, the amount received is deemed to be assessable income of the company in the year of disposal.

Policy

It appears that there is some confusion regarding the operation of section DN 1: specifically subsections (7) and (11).

Section DN 1 provides taxation rules for mining companies, and contains express provisions on the tax treatment of exploration and developmental expenditure, including the acquisition of an asset and its subsequent disposal. For the purposes of this article it is assumed that the acquisition of an asset constitutes exploration or development expenditure as defined in section OB 1.

Some taxpayers consider that there is a discretion whether to follow these rules, or alternatively to rely on the general provisions of the Act. They reason that if a deduction is not claimed on the acquisition of a mining asset, any proceeds on its sale are not assessable. The Commissioner does not agree with this reasoning.

It could be argued that the words in section DN 1 (7) "the Commissioner may, subject to subsection (12), allow a deduction" denote that the taxpayer is under no

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obligation to make a claim to deduct the cost of an asset acquired in an income year, (under subsection (11) the gross proceeds from the disposal of the asset are assessable). However, subsection (11) applies whether or not the taxpayer has made a claim. Therefore, attempting to make any profits on the sale of assets that are "capital" in nature by not claiming a deduction for them will not be effective, as the proceeds of any sale are assessable, regardless of whether or not a deduction was claimed on acquisition.

The above treatment also applies to Resident Mining Operators (section DN 4) and Non - Resident Mining Operators (section DN 5).

Questions we've been asked

This section of the TIB sets out the answers to some day-to-day questions that people have asked. We have published these as they may be of general interest to readers.

These items are based on letters we've received. A general similarity to items in this package will not necessarily lead to the same tax result. Each case will depend on its own facts.

Income Tax Act 1994

New Zealand soldiers in United Nations peacekeeping forces - tax status

Section CB 11 (section 64, Income Tax Act 1976) - Exemption from tax of pay of service personnel in operational areas: A tax agent has asked whether the income earned by a New Zealand soldier who is currently serving in a United Nations peacekeeping mission in Bosnia is exempt from tax.

There are two sections of the Income Tax Act 1994 that provide a tax exemption for certain payments made to members of the Armed Forces serving in areas of unrest.

Section CB 11 exempts from income tax the pay and allowances received from the New Zealand Government of any person engaged in any naval, military, or air force raised in New Zealand or in any other part of the Commonwealth for a period of service in an operational area. Under the section, a "special committee" comprising the Prime Minister, the Minister of Defence, and the Minister of Finance is able to define any specified area to be an "operational area" for the purposes of the section.

Section CB 9 (b) (section 61(16), Income Tax Act 1976) exempts income derived by any person from deferred pay. This relates to pay that meets both of these conditions:

- It is for service as a member of the New Zealand armed forces in an area outside New Zealand declared to be an active service area by the Minister of Defence, by notice in the Gazette, given with the consent of the Minister of Finance; and
- It is declared to be deferred pay by the Minister of Defence, by notice in the Gazette, given with the concurrence of the Minister of Finance.

Bosnia has not been declared an "operational area" or an "active service area" for the purposes of the 1994 Income Tax Act 1994. We therefore advised the tax agent that New Zealand troops currently serving in Bosnia as part of the United Nations peacekeeping force are treated as New Zealand residents for taxation purposes. Their pay is not tax exempt.

Riding school horses - valuation

Section EL 1 (section 86, Income Tax Act 1976) - Valuation of livestock generally: A taxpayer intends setting up a riding school. The cost of purchasing horses for the school will be substantial as there will be quality horses for the more experienced riders, as well as learner mounts. The horses will be used for breeding, and there could be some buying and selling of horses. The taxpayer has asked what the correct method is for valuing the horses.

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Under section EE 1 (1) (section 85, Income Tax Act 1976), any taxpayer carrying on a business must take into account the value of any trading stock, including livestock, at the beginning and end of each financial year in determining whether any assessable income has been derived.

The livestock values published by Inland Revenue each year are for specified livestock. The horses in this case are not specified livestock. They are an asset of the riding school. Section EE 1 (4) sets out the method for determining the value of livestock that is not specified livestock. Such animals are valued according to section EL 1 (1)(c) using one of the following:

- market value
- replacement value
- cost price
- standard value.

The taxpayer can elect to value the horses using any of the above methods.

Reasonable wages - payments to a spouse

Section GD 3 (section 97, Income Tax Act 1976) - Payment of excessive salary or wages, or allocation of excessive share of profits or losses, to relative employed by or in partnership with taxpayer: A taxpayer has set up a home based business, and intends paying his wife for clerical services. He has asked for details of the criteria used by Inland Revenue to determine what is a "reasonable" payment in this situation.

Under section GD 4 (section 106(1)(d), Income Tax Act 1976), a taxpayer who wishes to pay wages to a spouse is required to obtain the Commissioner's permission before a deduction will be allowed. The Commissioner needs to be satisfied that the payment is for services rendered or is otherwise a bona fide payment incurred in the production of assessable income by the taxpayer, for the income year.

Before a deduction will be allowed the Commissioner must be satisfied that the services have been rendered by the spouse, and that the deduction will be claimed in the tax return that covers the income year in which the services were performed.

If he considers that the salary or wage paid to a taxpayer's relative is excessive, section GD 3 allows the Commissioner to set what he considers to be a reasonable payment for the services rendered. If payment is made above this level, he will allocate the income based on the level set, i.e., the Commissioner may disallow a deduction for any amount paid above that level.

To determine what is a reasonable payment for the services rendered, the Commissioner will consider the following criteria:

- the nature of the services and the circumstances in which they will be or are performed
- the knowledge and skills required to carry out the services, including any particular qualifications
- the amount of payment that the person carrying out the duties would be paid by another independent employer for like services
- the locality where the duties are being performed
- the amount the taxpayer would be prepared to pay an arm's length employee undertaking similar duties.

Deductibility of expenditure in a consolidated group

Section HB 2 (1)(c) (section 191M(1)(c), Income Tax Act 1976) - Items to be included in group return of income: Co A and Co B are members of a consolidated group. Co A derives assessable income, and Co B derives no assessable income. Co B has been invoiced by third party Y and has made payment. Co A reimburses Co B for the expenditure. A group spokesperson has asked whether the reimbursement creates an “arrangement” between the companies that in some way prevents Co B claiming a deduction for the expenditure.

Section HB 2 sets out the types of income and expenditure that must or must not be taken into account when calculating the assessable income of a company that is a member of a consolidated group. This section ensures that a consolidated group is generally liable for income tax as if it were a single company.

Assuming the expenditure is expenditure that would otherwise be deductible, under section HB 2 (1)(c) Co B can claim a deduction for the payment made to third party Y as long as all of the following criteria are met:

- The expenditure does not fall within section HB 2 (1)(b).
- The expenditure would not, but for section HB 2 (1)(c), have been deductible in calculating Co B’s assessable income - section HB 2 (1)(c)(i).
- The expenditure would be deductible if the consolidated group were one company because a nexus can be shown between the expenditure incurred and the assessable income of another member of the consolidated group - section HB 2 (1)(c)(ii).

Co B’s payment to third party Y does not fall within section HB 2 (1)(b) because:

- It was not incurred by virtue of a payment or disposition to, or other transaction or arrangement with, another member of the consolidated group - section HB 2 (1)(b)(i).
- It would be a deductible expense if Co B and Co A were one company, because it would have been incurred in deriving assessable income - section HB 2 (1)(b)(ii).

The payment by Co B to third party Y would not ordinarily be deductible under section BB 7 as Co B derives no assessable income. The reimbursement by Co A is ignored when ascertaining whether Co B derives any assessable income, because under section HB 2 (1) the following types of assessable income derived by Co B are not taken into account:

- assessable income derived from a transaction or other arrangement with any other company that is a member of the same consolidated group - section HB 2 (1)(a)(i)
- assessable income which would not be assessable income if the company and the other company were one company - section HB 2 (1)(a)(ii).

Co B’s “reimbursement” by Co A does not prevent Co B claiming a deduction for the expenditure incurred in paying third party Y.

Co A may not claim a deduction for the expenditure it incurs when reimbursing Co B. Such a “reimbursement” is an intra-group expense which is not deductible under section HB 2 (1)(b) because:

- It was incurred by virtue of a payment to another member of the consolidated group - section HB 2 (1)(b)(i).
- It would not be deductible if Co A and Co B were one company because payments paid by a taxpayer to itself are not deductible - section HB 2 (1)(b)(ii).

However, section HB 2 (1)(b) does not deny Co B a deduction for the payment it made to a third party.

Earliest date at which a newly incorporated company can become a QC or LAQC

Section HG 3 (section 393C, Income Tax Act 1976) - Director elections, and revocation of director elections: A taxpayer advised that she is a director of a newly formed company incorporated on 20 June 1995. She has asked for details of the earliest date at which the company can become a qualifying company (QC) and a loss attributing qualifying company (LAQC). The company has a 31 March balance date.

Under section HG 3 (3), a newly formed company may elect to be a QC from the first day of the company's first income year. Following on from this, under section HG 14 (c) (section 393N(c), Income Tax Act 1976), a newly formed company may also elect to become an LAQC from the first day of the company's first income year. In both cases the company must give the Commissioner a notice of election within the time allowed under section 37 of the Tax Administration Act 1994 (section 17, Income Tax Act 1976) for the company to file its income tax return for its first income year.

The notices of election (IR 4PE for a QC and IR 4PL for an LAQC) must be made in writing to the Commissioner. Under section HG 3 (1), QC elections must be made by all the directors of the company. Under section HG 4 (1) (section 393D(1), Income Tax Act 1976), QC elections must also be made by all shareholders of legal capacity. (Limited exceptions apply)

For the company to become an LAQC, all of its shareholders and directors at the time of the election who are of legal capacity must complete a notice of election for the company to be an LAQC (section HG 14 (c)(i)).

If the company in this case meets the QC rules, the earliest it could become a QC and an LAQC is the date of incorporation - 20 June 1995.

For a full policy statement on the time limits for new companies to make QC elections, see page 4 of TIB Volume Six, No. 13 (May 1995).

Imputation credits and trust losses

Section LB 2 (section 394ZE, Income Tax Act 1976) - Credit of tax for imputation credit: A trustee has received dividend income with imputation credits attached. The dividends are retained as trustee income, but the imputation credits exceed the trustee tax liability. The trustee has asked how the remaining credits may be utilised.

A trustee is taxed as an individual taxpayer. When dividends are assessed as trustee income, they form part of the total trust income and are assessed accordingly. When a dividend received by a trustee as trustee income has an imputation credit attached, the trustee is subject to tax on that dividend, including the amount of any attached imputation credits. Tax is paid on trustee income at the fixed rate of 33%, and no individual rebates are available.

Under section LB 2 (1), when the trustee's assessable income includes any imputation credit, the trustee can claim a tax credit for the amount of the imputation credit. Under section LB 2 (2), the tax credit can only be used to meet income tax liabilities on trustee income.

To the extent that tax credits cannot be used by a trustee, they are deemed to be a loss and may be carried forward to succeeding income years. The amount of the loss to be carried forward is calculated using the formula set out in section LB 2 (3).

When the trust is ultimately wound up, unused credits that have been converted to losses and not used are lost. The converted losses may not be reconverted into credits in later years, nor may they be passed over to beneficiaries.

Special tax code (STC) certificates and rental loses

Section NC 14 (section 351, Income Tax Act 1976) - Special tax code certificates: An employee owns a rental investment property. From the expenses incurred this year, she has calculated that she will incur a tax lose on the property in the 1996 income year. She has asked if she can have a special tax code (STC) to reduce her PAYE deductions to reflect the anticipated loss.

An STC applies when an employee expects the amount of tax deductions made from salary or wages during the year to exceed or to be less than the end of year tax liability if the deductions are made at ordinary tax rates.

Section NC 14 (1) states:

> Where the Commissioner in any case thinks fit (whether by reason of the employee being employed on 2 or more employments, or being entitled to have any loss carried forward under section IE 1, or by reason of any reduction under section NC 13, or for any other reason), the Commissioner may issue to an employee a special tax code certificate under this section.

In this employee's case, at this stage the loss is an anticipated loss. In order for an STC to be issued for anticipated deductible losses, it is the Commissioner's policy that an application for a certificate should be supported with a detailed budget of proposed income and expenditure.

The issue of an STC does not mean that the Commissioner accepts that there will be a loss. This will only be determined when the employee files her tax return and all the facts giving rise to the loss have been fully considered from the details supplied in the return.

After-hours payments to midwives - tax treatment

Section OB 1 (section 2, Income Tax Act 1976) - Definitions of " monetary remuneration" and "salary or wages": A Crown Health Enterprise (CHE) employs a number of midwives. The CHE has offered the midwives additional money for making after-hour calls. The midwives will be paid a fixed fee plus generous mileage allowance. A midwife has asked what the income tax and GST implications will be for each of these payments.

Section OB 1 defines "monetary remuneration" as:

> ... any salary, wage allowance, bonus, gratuity, extra salary, compensation for loss of office or employment, emolument (of whatever kind), or other benefit in money, in respect of or in relation to the employment or service of the taxpayer; and includes - ...

Section OB 1 defines "salary or wages" as:

> in relation to any person, means salary, wages, or allowances including all sums received or receivable by way of overtime pay, bonus, gratuity, extra salary, commission, or other remuneration of any kind, in respect of or in relation to the employment of that person; and includes- ...

The income received constitutes monetary remuneration as defined in section OB 1, and as such is subject to PAYE.

Under the former section CB 12 (section 73, Income Tax Act 1976), the Commissioner could determine to what extent any allowance was a reimbursement of expenditure incurred in earning assessable income. To the extent that the allowance was a reimbursement as required, the allowance was exempt from income tax. From 1 April 1995, sections CB 12 and CB 13 (section 73A, Income Tax Act 1976) were repealed and a new section CB 12 substituted. From that date, an employer can pay a tax free allowance to an employee without obtaining the Commissioner's permission.

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The mileage allowance has been described as "generous". On page 1 of TIB Volume Seven, No.1 (July 1995), the Commissioner has issued motor vehicle rates that are acceptable to Inland Revenue. If the allowance paid to the mid-wives exceeds these rates, the excess becomes a taxable allowance. The taxable allowance must be treated as part of the salary or wages, and PAYE deducted accordingly.

There are no GST implications with either payment, because contracts of service are excluded from the definition of a "taxable activity".

Goods and Services Tax Act 1985

Part-time tutoring - whether a taxable activity

Section 6 - Meaning of term "Taxable activity": A GST registered horticulturist has had an offer to do some part-time tutoring at her local polytechnic. A contract for her services is being drawn up, and she has asked if GST should be included in the proposed hourly rate.

If the horticulturist is engaged by the local polytechnic as an employee, rather than as self-employed, under section 6(3)(b) she cannot be carrying on a taxable activity for her tutoring and the tutoring income will not include GST.

Section 6(3)(b) excludes from the definition of taxable activity:

> Any engagement, occupation, or employment under any contract of service or as a director of a company.

If the horticulturist is employed under a contract for services, and is self-employed, those services would be considered to be a taxable activity. As she is already registered for GST, that registration covers all taxable activities that she undertakes.

In this case, it has been determined that she is self-employed and that the part-time tutoring is a taxable activity. Accordingly, we advised her that as her GST registration also covers her tutoring services, she should include GST in the proposed hourly rate.

Land sold for residential purposes - GST

Section 8 - Imposition of goods and services tax on supply: A GST registered golf club is planning to build a new clubhouse. As a means of raising funds, it is going to subdivide a 1,000 square metre block of land off from the golf course and sell it as a residential section. The club's secretary believes that the sale of land is not part of the club's taxable activity, and that the proposed residential status of the block would in any event make the sale exempt from GST. She has asked for Inland Revenue's view.

Section 8(1) imposes goods and services tax at the rate of 12.5 percent:

> ...on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after the 1st day of October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply.

The sale of the block of land is the supply of an asset of the club, and is a supply made in the course or furtherance of a taxable activity. The fact that the club is not in the business of selling land does not affect its liability to account for GST on the supply of one of its assets.

As to whether the proposed residential status of the block affects the nature of the supply - exempt or taxable - it is necessary to refer to section 14 which gives details of supplies exempt from tax. The supply by way of sale of unimproved land is not included in section 14 and so it is a supply subject to section 8. The use to which purchasers may put the land is not relevant.

The club must account for GST at 12.5 percent on the sale of the land. It can claim input tax deductions for expenses incurred in making the sale, provided the tax invoice requirements of section 24 are met.

Child Support Act 1991

Deductions when liable parent ceases employment

Section 163 - Payment of deductions to the Commissioner: An employer who runs a small business has advised Inland Revenue that her sole employee has left without giving notice. She was deducting Child Support payments along with PAYE on behalf of the employee, and has asked what she should do.

Under section 163, an employer who has made a deduction for Child Support from any money payable to a liable person must, by the 20th of the following month:

(a) Pay to the Commissioner every sum so deducted to the credit of the liable person; and

(b) Supply to the Commissioner, in the approved form, the particulars required by the form.

Under section 163 an employer must notify Inland Revenue of the amount of Child Support deducted each pay by completing the IR 66S or IR 66C deduction schedules. The IR 66C schedule is used by employers with 6 or more employees who have Child Support or Student Loan repayments deducted. Normally, the information does not vary, but if any of the following reasons for change exist they must be noted by a "variation code" on the form:

- Payments have been made in advance - Code A.
- Employment has ceased - Code C.
- The amount has already been deducted - Code D.
- Earnings are protected (this means that an employer cannot deduct more than 40% of an employee's net salary as child support deductions) - Code P.
- There are short-term absences in the employee's employment - Code S.

In this case, the employer must deduct Child Support payments from the last pay, including any holiday pay due to the employee. She must enter the variation code "C" on the IR 66S form to notify Inland Revenue that the employee has left her employ.

When Inland Revenue is advised that an employee has left, we will issue a cessation notice to the employer and employee.

Tax Administration Act 1994

This is the second in a series of questions and answers on the binding rulings process. They include questions raised at the 1995 Tax Conference of the New Zealand Society of Accountants and other questions and issues referred to us.

Disclosure of "propositions of law" in binding ruling application

Section 91ED - Disclosure requirements: A taxpayer is drafting a private ruling for submission to Inland Revenue. She has located several cases from New

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Zealand and Australia, plus a Privy Council case out of Hong Kong, which support her stance. She has made reference to these in her submissions. She is also aware of a case which goes against her and has asked whether she is required to cite this case in her application. She has also asked whether it would make any difference if the latter case is a New Zealand case or one from another Commonwealth jurisdiction.

Under section 91ED (1)(d) an application for a private ruling "must state the propositions of law (if any) relevant to the issues raised in the application." The applicant must provide any legal reasons and arguments supporting the preferred interpretation. Inland Revenue requires legal propositions based on statutory wording, case law, and/or established legal principles, and not merely assertions that a particular interpretation applies. This will often involve both quoting potentially relevant cases and demonstrating a linkage between the case and the matter being ruled on.

The applicant must provide all the material needed for the Commissioner to arrive at a correct decision. The test is a combination of relevance and materiality. Section 91EB(2)(b) provides that a ruling will not apply to a particular arrangement if there was "a material omission or misrepresentation in, or in connection with, the application". If significant authorities exist which are contrary to the applicant's interpretation, and which have not been referred to in the application, then the Commissioner may consider whether the fact that reference was not made to these authorities effectively amounted to a material omission. In the above example, the case which contradicts her view, presuming the facts are similar to her own or the legal principles are directly on point, could well be relevant to the issue she has raised.

The fact that the case is from another jurisdiction will influence the relative significance of the authority. For example, some Courts and jurisdictions are more persuasive to New Zealand Courts than others. In the case of the Privy Council, its position in New Zealand's court structure is even more likely to make its decisions highly relevant in this country.

In any event, it would ordinarily be in an applicant's interest to refer to contrary authorities in the application, so as to present the arguments countering their application (rather than finding later on that the Commissioner is seeking to rely upon them in his ruling).

Non-disclosure of names of those who may be party to the arrangement

Section 91ED - Disclosure requirements: On 2 April 1996, a taxpayer applies for a private ruling on a completed transaction. The documents relating to the transaction include the name of the other party to the transaction. The other party has expressly requested that they not be named in any approach to Inland Revenue. Can Inland Revenue give a ruling on this basis?

Ordinarily, Inland Revenue requires names of all parties to an arrangement to be identified.

In exceptional cases, when this requirement will give rise to particular difficulties, beyond such matters as commercial sensitivity or contractual secrecy obligations, Inland Revenue may accept an application without the disclosure of all parties. However, the Commissioner must be satisfied that there is a specific arrangement (between actual parties) that is seriously contemplated (in the case of prospective transactions), and all material attributes of the undisclosed party must be provided. In these cases, we recommend that the applicant contact the

Rulings division prior to application outlining the precise reasons for the desire to omit one party's name from the application. If Rulings indicates that an application could be made without disclosure of all parties' identities, the reasons for non-disclosure should be confirmed in detail in the rulings application. Disclosure of the applicant's details is always required.

Whether a ruling can be made when the applicant company has not been formed

Section 91E - Commissioner to make private rulings on request: Three construction firms intend forming a company for the purpose of building a retail shopping complex. The firms have applied for a binding ruling on a deductibility aspect of the proposed development project and Inland Revenue's response to the application will depend on whether the new company is brought into existence. Is Inland Revenue prevented from ruling on the application for a binding ruling because there is technically no applicant?

To help taxpayers in entering into developments such as this one, Inland Revenue will accept applications for rulings on matters which by necessity must be decided prior to incorporation. In this example, we would provide a draft ruling to the soon-to-be-incorporated company if its agent applied for one. However, the agent must give Inland Revenue an undertaking dealing with the application that it will fulfil all obligations required of it as if it were an applicant for a binding ruling (particularly including the payment of fees). Also, care must be taken to ensure that the underlying parties are seriously contemplating the proposed "arrangement". Once the company is incorporated Inland Revenue will issue a final ruling.

Whether Inland Revenue can rule when we are required to consider criteria under another Act

Section 91C - Taxation laws in respect of which binding rulings may be made: On 2 April 1996 a commercial passenger aircraft operator applies for a ruling on whether the fares it charges passengers who are in New Zealand as part of a round the world package can be zero-rated for GST purposes. The taxpayer's agent has referred to section 11(2)(aa) of the GST Act 1985.

Section 11(2)(aa) provides zero-rating for services comprising the transport by air of passengers within New Zealand if the transport constitutes "international carriage" for the purposes of the Carriage by Air Act 1967. Section 91C(1) of the Tax Administration Act specifies the provisions which comprise "taxation law". The issue is whether Inland Revenue can rule when it must consider criteria under another Act which is not "taxation law".

Inland Revenue will rule in these circumstances. Section 91 E(1) requires the Commissioner to rule, on application, on how any taxation law applies to a particular arrangement. Inland Revenue accepts there is an "arrangement" in the above example. "Taxation law" is defined and includes any provision of the GST Act 1985, except sections 12 and 13. In the course of ruling on how the "taxation law" (i.e., section 11(2)(aa) of the GST Act) applies to the arrangement the Commissioner will need to be satisfied as to the status of the applicant's activities under the Carriage by Air Act 1967. The Commissioner is therefore required to interpret this latter Act for the purpose of ruling on how the taxation law applies to the arrangement in question.

Ruling on questions of fact

Section 91E - Commissioner to make private rulings on request: A taxpayer has a two hectare block of land which he is looking at developing and dividing into lots for future resale. He is aware that any profit he makes on the undertaking will be assessable income under section CD 1(2)(g) of the Income Tax Act 1994 and has applied for a private ruling on the market value of the land as at the proposed start of the undertaking in terms of section CD 1(9). Can the Commissioner rule on this matter?

The Commissioner is required under section 91 E(1) to rule, on application, on how any taxation law applies to a particular arrangement. However, under section 91 E(4)(a) he cannot rule if it would require him to determine questions of fact. Therefore, because the application involves ruling on the market value of an asset (which is a matter of fact, not law), the Commissioner cannot rule due to his having to determine a question of fact.

Correction - when an arrangement is “entered into”

We have noted that the last sentence in one of the items in last month’s Tax Information Bulletin was somewhat confusing.

The item, *When an arrangement is “entered into”*, appears on pages 28 and 29. The last sentence on page 29 should read:

“Therefore, *a ruling given on* a conditional or unconditional contract/arrangement entered into before the Commissioner withdraws a private ruling, will be binding on him”. (inserted text in italics)

Legal decisions - case notes

This section of the TIB sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, the Court of Appeal and the Privy Council.

We have given each case a rating as a reader guide to its potential importance.

• • • • •	Important decision
• • • •	Interesting issues considered
• • •	Application of existing law
• •	Routine
•	Limited interest

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision. Where possible, we have indicated if an appeal will be forthcoming.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

Business purchase - deductibility of lease and depreciation

Rating: •

Case: TRA 95/50

Act: Goods and Services Tax Act 1985 - section 11(1)(c)
Income Tax Act 1976 - section 108 (Income Tax Act 1994 - section EG 1)

Keywords: *going concern, depreciation*

Summary: The Authority held that the Commissioner acted correctly in disallowing the deductions claimed for lease amortisation. There was a purchase of a business as a going concern and not the buying of a lease. The Authority also held that there was no factual basis on which the Commissioner could allow the claim for depreciation of assets.

Facts: The objector owned and operated a real estate business. It entered into an agreement for sale and purchase on 14 June 1989 to purchase the premises of a rival real estate agent. The agreement was on the Standard Real Estate Institute of New Zealand and Auckland District Law Society form. The transaction was zero-rated.

The Authority highlighted a number of important events:

- On 9 August 1989 the objector gave a receipt to the vendor for entries in their tenancy register dated from 18 April 1988 through to 13 July 1989 in compliance with the agreement.
- On 11 August 1989 the objector wrote to all clients of the vendor's business informing them that the objector had purchased the business of the vendor.
- On 6 September 1989 the objector's solicitor wrote to the vendor requesting the vendor to account to the objector for all files, computer tapes, documents and other business records and to direct all former clients of the vendor to return to the objector's business.

The objector sought to deduct what it claimed to be lease payments from assessable income in the years 1990 to 1993. The Commissioner considered that the

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evidence showed the purchase of a business as a going concern and not merely the buying of a lease. The Commissioner declined to allow the claim to deduct the purchase price as being a premium paid for the lease.

The objector also sought to deduct an amount representing depreciation on obsolete assets taken over when entering into the lease. The Commissioner contended that there was no allowable depreciation claim.

Decision: The Authority held that the documentary evidence of the transaction and the actions of the objector following settlement pointed overwhelmingly to the purchase of a business as a going concern. The Commissioner was correct in disallowing the objector's claim to amortise the purchase price of the business as a lease premium payment and deduct it in the relevant year.

With respect to the objector's claim to deduct as depreciation the value of the assets purchased, the objector had the onus of showing that the Commissioner was wrong in fact or law in not allowing the depreciation claim. The only evidence about the disposition of assets came from a chartered accountant who said all the assets in question were scrapped shortly after the purchase. The Authority held that such sparse evidence did not satisfy the onus of proof. There was no factual basis on which the Authority could further deal with this aspect of the objection and the objector failed.

Comment: We do not yet know whether the taxpayer will be appealing this decision.

Film expenditure and royalty payments - deductibility

Rating: • • •

Case: DB Productions Ltd v CIR M 577/94
DB Group Limited v CIR M 576/94

Act: Income Tax Act 1976 - sections 2, 224A(1), (5), (6), 224D(1), (3) and (6)
(Income Tax Act 1994 - sections OB 1, EO 3(4), (5), (9), EO 4(1) and (4))

Keywords: *deductibility of film expenditure, feature film, royalty payments*

Summary: The High Court held in favour of the objector and its subsidiary, DB Group Ltd.

The Court found that in the case stated for DB Productions Ltd ("the objector") the Commissioner had acted incorrectly in disallowing expenditure incurred in relation to the film "The Navigator". It held that expenditure incurred in acquiring the film or any right in the film was deductible under section 224A(6) and that payments made for the production of the film constituted film production expenditure and were therefore deductible under section 224D(6). Also, the Court found that the payment for the right to market, distribute and sell the film was not a payment in the nature of a royalty. It was a payment for the absolute assignment and ownership of the right.

In the case of DB Group Ltd, the Court held that having regard to the judgment given in relation to DB Productions Ltd the Commissioner had incorrectly amended the subvention payments or the losses to DB Group Ltd.

Facts: The objector incurred expenditure in acquiring certain rights in relation to the film "The Navigator". The objector entered into three interlocking agreements under which payments were made for the production of the film ("investment agreement"), for a licence to market, distribute and sell the film ("licence agreement") and for certain ancillary rights relating to the outright purchase of the film ("acquisition agreement").

The objector claimed a deduction for the payments on the basis that the film was not a feature film and part of the expenditure was film production expenditure. The Commissioner disallowed the expenditure on the basis that the film was a feature film and that the production expenditure had not been incurred. In addition, the Commissioner contended that, in substance if not in form, the payment under the acquisition agreement constituted a payment in the nature of a royalty in terms of the extended definition of a royalty under section 2. Accordingly, the Commissioner assessed the objector for non-resident withholding tax on the acquisition agreement.

As a consequence of adjusting the objector's losses a secondary issue arose regarding the amount of losses available to be transferred to its subsidiary, DB Group Ltd. The Commissioner amended the subvention payments or the loss offsets to DB Group Ltd for the years in question.

Decision: Justice Doogue considered the following three issues: (i) whether the film was a feature film; (ii) whether the amount paid under the acquisition agreement was a royalty attracting non-resident withholding tax; and (iii) whether the sum paid under the investment agreement represented film production expenditure.

On the first issue, Justice Doogue found that the film "The Navigator" was not a feature film. The film was not produced primarily and principally for exhibition in a cinema. The principal revenue and viewing markets were television and video screening. Accordingly, the expenditure incurred in acquiring the film or any right in the film was deductible under section 224A(6).

The next question was whether the payment under the acquisition agreement was a royalty payment. Justice Doogue did not accept the Commissioner's argument that the rights being acquired under the acquisition agreement could be enjoyed only by the use of or by exercising the right to use them. He held that in this case the payment under the acquisition agreement was for the outright purchase of the rights. On this basis the amount paid under the acquisition agreement was not a royalty payment. In reaching his decision, Justice Doogue considered that the rights purchased do not have to be used, rather they may be purchased simply to prevent someone else obtaining them. Even if the rights were used, he considered that there was nothing that equated the sum paid for the outright purchase of the rights with the payment of a royalty.

On the third issue, Justice Doogue found that the payments made under the investment agreement were payments which constituted film production expenditure under section 224D(1) and accordingly the expenditure was deductible under section 224D (6). In terms of the agreements to which the objector was a party, it had proven to the Court's satisfaction that the objector was a direct contributor to the film and that payments made under the investment agreement were film production expenditure. Although there was no direct evidence that the film production expenditure had been incurred, the completion of the film and the fact that the objector contributed directly to the cost of producing "The Navigator" were sufficient to show that the costs had been incurred.

In the case of DB Group Ltd, Justice Doogue did not give independent consideration to whether the Commissioner had acted correctly in amending the subvention payments or the loss offsets. He held that, in finding that the Commissioner had acted incorrectly in disallowing the expenditure incurred by the objector, the assessments for DB Group Ltd were also incorrect.

Comment: Inland Revenue has not yet decided whether to appeal this decision

Company in liquidation - whether former receiver and tax agent's objection and case stated request valid

Rating: • • • •

Case: TRA No. 94/159

Act: Taxation Review Authority Regulations 1974 - Regulation 5
Companies Act 1955 - section 226, 240(1) and (3) Companies Act 1993 - section 248(1)(c)

Keywords: *invalid case stated request, invalid objection, company in liquidation, objection process*

Summary: An objection to a GST assessment and a request for a case stated made on behalf of a company in liquidation were found to be invalid. The objection and request for a case had been lodged by the company's tax agent who had earlier ceased to act as the receiver and manager of the company. The current liquidator neither wished to object to the assessment nor had authorised the tax agent to do so.

Facts:

(a) In June 1990 a winding up order was made against the company by the High Court and the Official Assignee was appointed provisional liquidator. The tax agent had been receiver and manager of the company since 1988 under a debenture dated November 1986.

(b) In July 1992 the tax agent notified the Companies Office that he had ceased to act as receiver and manager of the company on 20 July 1992.

(c) In July 1993 the Commissioner made a GST assessment for the company's April 1987 taxable period. The GST return for that period had been filed by the tax agent in July 1991.

(d) In August 1993 the tax agent objected to the assessment on behalf of the company. In December 1993, following advice that the objection had been disallowed, he requested a case be stated for determination by the Taxation Review Authority.

(e) In July 1994 the Commissioner wrote to the tax agent explaining in detail why it was not possible to state such a case.

(f) In December 1994 an application was made to the Taxation Review Authority on behalf of the company, seeking to have the objection to the GST assessment allowed. This was on the grounds that the Commissioner had failed to file a case stated within the six month period provided under Regulation 5 of the Taxation Review Authority Regulations 1974.

Decision: The Authority confirmed that from 20 July 1992 the tax agent had ceased to act as receiver and manager of the taxpayer company. The Authority also held that the question of any objection to the GST assessment was a matter for the Official Assignee as liquidator of the company to raise if so desired.

In giving his decision the Authority referred to provisions of the Companies Act 1955 and Companies Act 1993 and in particular sections 226 and 240 of the 1955 Act and section 248(1)(c) of the 1993 Act. These provisions make it clear that on a liquidation all proceedings involving a company are frozen and can only be reactivated, continued, commenced, or otherwise dealt with by the liquidator, with the consent of the High Court if necessary.

An affidavit filed on behalf of the Official Assignee stated that the Official Assignee had no wish to object to the assessment nor had he authorised the tax agent to do so. The objection and subsequent case stated request lodged by the tax agent were therefore invalid and the Authority ruled the Commissioner was accordingly under no obligation to file a case stated for determination by the Taxation Review Authority.

Comment: The taxpayer is appealing this decision.

Trading profit received upon settlement - whether assessable income

Rating: • • • •

Case: GPO Holdings Limited v CIR M1126/94

Act: Income Tax Act 1976 - 64B, 65(2), 65(2)(a), 65(2)(l) and 65(2)(jb)
(Income Tax Act 1994 - sections OB 1, BB 4, BB 4(a), (d) and CE 1 (1)(c)).

Keywords: *assessability of pre-acquisition profits, sale of government assets*

Summary: Trading profit of $7,641,000 had accumulated over the period of five months between the execution of a sale and purchase agreement and its settlement. This profit was payable to the objector on settlement, and the issue was whether it was assessable in the hands of the objector.

The High Court held that some of the $7,641,000 trading profit was not assessable. The High Court found that until the "nomination agreement" of 27 June 1990 the objector did not have a legally enforceable right to receive trading profits. Accordingly, of the $7,641,000 received by the objector on settlement only $102,564, which represented income derived by the business from 27 June 1990 to settlement on 29 June 1990, was assessable income.

Facts: In the late 1980s the NZ Government ("Crown") decided to sell the business of Government Printing Office ("GPO") as a going concern. Rank Group Limited ("Rank") tendered for the business and in December 1989 the Crown accepted its tender. Before the signing of the formal sale and purchase agreement, Rank informally advised the Crown that the purchase would be completed through its subsidiary, GPO Holdings Limited ("the objector").

On 24 January 1990, the Crown entered into an agreement with Rank (or a nominee of Rank) for the sale of the business of GPO ("the business") for $23,000,000 subject to an adjustment for revaluation of assets. A condition of the agreement for the sale and purchase ("the agreement") was that Rank was entitled to "the benefit of the business" in the event that the settlement date was later than the audit date of 31 January 1990. In return, Rank was required to pay interest to the Crown based on the purchase price.

On 7 March 1990, the Crown and Rank entered into a variation agreement. This agreement cancelled Rank's obligation to pay interest pending settlement and clarified in greater detail clause 2.5 of the original agreement. In particular, the variation agreement provided that Rank was entitled to the cash generated by the business from the audit date to the possession date. The broad effect was that Rank would receive the result of trading and asset realisation between the date of the agreement and settlement.

On 27 June 1990, Rank entered into a "deed of nomination and covenant" ("nomination agreement") nominating the objector to complete the purchase of and take transfer of assets and liabilities from the business. The agreement was settled on 29 June 1990 and during the delay between execution of the agreement and its settlement the business made a trading profit of $7,641,000.

The Commissioner initially issued a nil assessment for the year ended 31 March 1990, but later issued amended assessments for the years ended 31 March 1990 and 31 March 1991 which assessed trading profits of $7,641,000 between these two years. The objector objected to the amended assessments issued, on the grounds that it was not a party to the original agreement with the Crown, and that the agreement remained conditional until settlement on 29 June 1990. The Commissioner disallowed the objection and a case was stated.

Decision: **Preliminary considerations - the objector's legal rights to accumulated trading profit**

Before considering whether the trading profit of $7,641,000 received by the objector on settlement represented assessable income, Justice Fisher addressed

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two preliminary issues put forward by the objector. These issues were aimed at establishing whether the objector had a legal right to accumulated trading profits.

(i) Whether the party to the original agreement for sale and purchase with the Crown was Rank and not the objector.

Justice Fisher found that the objector was not a party to the original agreement for sale and purchase with the Crown. Although, at the time of the execution of the agreement it was clear that the Crown, Rank and the objector contemplated that upon settlement the business would be conveyed by Rank to the objector. Until the "nomination agreement" of 27 June 1990, the objector had not acquired an assignment of Rank's rights as purchaser with respect to the agreement.

(ii) To what extent was the agreement for sale and purchase conditional

Justice Fisher considered that until the settlement date of 29 June 1990 the contract was fully conditional in the conventional legal sense. However, by 27 June 1990, when the objector acquired rights pursuant to the "nomination agreement", there was a high probability that the agreement would become unconditional.

Bases for assessing the objector on trading profits

Once the Court determined that the objector had acquired a legal right to accumulating trading profits of $7,641,000, from the "nomination agreement" of 27 June 1990, Justice Fisher then considered the bases for assessing tax.

Justice Fisher rejected the Commissioner's argument that the entire $7,641,000 should be taxed under section 65(2) and 65(2)(l) on the basis that that amount did not have the character of income. Rather, Justice Fisher considered that the $7,641,000 received on settlement represented the purchase price of assets purchased in a single capital transaction. He held that there was no necessary connection between the character a payment had in relation to the payer and its character as a receipt by the payee.

However, Justice Fisher found that trading profits of $102,564, derived by the business over the two days between assignment and settlement, should be treated differently. His Honour found, on general accounting principles, that the objector had a legally enforceable right to receipt of trading profits accruing after 27 June 1990. Therefore, of the $7,641,000 accumulated trading profits received by the objector on settlement, only $102,564 represented its assessable income derived in the tax year ended 30 June 1991.

The Commissioner further submitted that the accumulated trading profits of $7,641,000 represented the objector's assessable income (i) as compensation for lost profits (section 65(2)), (ii) a business contract entered into for the purpose of making a profit (section 65(2)(a)) and (iii) under the accruals regime (section 65(2)(jb)). Justice Fisher found that these arguments added nothing of consequence to the conclusion already reached that according to general principles no tax was payable beyond that payable for the last two days prior to settlement.

In addition, Justice Fisher specifically rejected the argument for assessability under the accruals rules. In particular, he considered that the objector was not a party to the agreement for sale and purchase of 24 January 1990, and consequently there was not a "promise", by the Crown to provide the business of GPO, sufficient to support a "financial arrangement" for the purposes of section 64B.

Comment: We do not yet know whether either party will be appealing this decision.

Medical Council of New Zealand - whether exempt from income tax

Rating: • • • •

Case: CIR v Medical Council of New Zealand AP 4/95

Act: Income Tax Act 1976 - sections 2, 61(2) and 61(25)
(Income Tax Act 1994 - sections CB 3, CB 4(1)(c) and OB 1)

Keywords: *public authority, charity, charitable purposes, exempt income*

Summary: The High Court dismissed the Commissioner's appeal against the decision of the Taxation Review Authority reported as *Case Q50* (1993) 15 NZTC 5,264. Justice McGechan confirmed that the Medical Council of New Zealand was both:

(i) A "public authority" and therefore exempt from income tax under section 61(2) of the Income Tax Act 1976; and

(ii) Established exclusively for charitable purposes and exempt from income tax under section 61(25) of the Income Tax Act 1976.

Facts: The Medical Council of New Zealand is a statutory body created and governed by the Medical Practitioners Act 1968. Its primary functions are to maintain a formal register of medical practitioners; maintain discipline within the medical profession; oversee the undergraduate and postgraduate education of medical practitioners; identify and suspend or rehabilitate impaired medical practitioners; and advise, provide statistical information and administrative services to the Minister of Health as required.

The Council derives interest income from the investment of annual fees levied from medical practitioners. The case related to the assessment of this interest income for the 1989 and 1990 income years.

The Taxation Review Authority ruled that the Council was a "public authority" as defined in section 2 of the Income Tax Act 1976, and thus exempt under section 61(2); and was established exclusively for charitable purposes, and thus exempt under section 61(25).

On appeal, the Commissioner argued that the Council:

(i) did not come within the statutory definition of "public authority" because the Council was not "part" of nor an "instrument of" the Executive Government. It was submitted that it did not have sufficient agency relationship with Executive Government; and

(ii) was not established "exclusively for charitable purposes" because the Council's main function was the registration of medical practitioners. It was submitted that the functions of the Council were not materially distinguishable from those in *General Medical Council v IRC* (1928) 13 TC 819 and *General Nursing Council v St Marylebone Corporation* (1959) AC 540 both of which ruled against charitable status.

Submissions for the Council contended that:

(i) Using a "plain meaning" approach the Council was an instrument of Executive Government. Additionally, the submissions looked at the wider term "public authority" and drew a comparison with State Owned Enterprises. If State Owned Enterprises could be regarded as within the meaning of that term thus requiring specific exclusion in section 61(2), the Council should be regarded likewise.

(ii) In relation to the charitable purposes question, the approach taken in the *General Medical Council* case was not consistent with the approach in recent decisions in New Zealand leading to ultimate benefit to the public.

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Decision: Justice McGechan did not accept the Commissioner's arguments, and found for the Council on both questions:

(i) "Instrument of the Executive Government of New Zealand"

The Judge considered that the Council fitted within the obviously broad Parliamentary intention that bodies set up to discharge functions of government, not involving commercial operations, should be exempt. "If one adds together constitution by statute, majority appointments at the instance of the Minister, and delegated exercise of regulatory controls which are a proper function of government, there can be no sensible doubt the Council is within the particular statutory scope of an 'instrument of the Executive Government of New Zealand'". The Council therefore came within the term "public authority" as defined in section 2 of the Income Tax Act 1976 and was exempted from income tax by section 61(2) accordingly.

(ii)Institution established exclusively for charitable purposes

Justice McGechan held that registration of medical practitioners was not "the main function" of the Council although it was a main function, and the original function. The Judge acknowledged that the 1928 *General Medical Council* case which found against charitable status could not be distinguished on its facts. However, he considered that the law has moved on since that case from focusing on "immediate object" to "wider purpose". When benefit to the profession and the public benefit are intertwined, the professional benefit need not disqualify the institution from having an exclusively charitable purpose.

Justice McGechan concluded that the Council's registration, disciplinary, educational, disability and advisory functions had as their main object public protection ("beneficial to the community"). Benefits to medical practitioners of registration and from these other functions were no more than ancillary, secondary, subordinate, or incidental to that public protection purpose. The Council was therefore an institution established for exclusively charitable purposes and exempt from tax under section 61(25) of the Income Tax Act 1976.

Comment: Inland Revenue has not yet decided whether to appeal this decision.

Land purchase - GST input tax credit claim

Rating: • • •

Case: TRA No. 94/156

Act: Goods and Services Tax Act 1985 - sections 2(1), 9(1) and 20

Keywords: *input tax, payment, time of supply*

Summary: The taxpayer could claim a GST input tax deduction on the purchase of land when the full amount of GST and a deposit were paid at the time of signing the contract, but the balance of the purchase price was not payable until a later date.

Facts: The taxpayer (purchaser) entered into an agreement for the sale and purchase of a block of land in October 1993. Both the vendor and purchaser were registered for GST. The purchaser accounted for GST on a payments basis while the vendor accounted for GST on an invoice basis. On the invoice basis of accounting for GST the vendor was required to account to the Commissioner for GST on the sale of the block of land in the GST payment period immediately following the signing of the contract. The parties agreed that the purchaser would pay a deposit and the full amount of GST to the vendor on signing the agreement. The balance of the purchase price was to be paid approximately 12 months later. The taxpayer sought to deduct the GST payment as an input tax in its GST return of 31 October 1993.

The Commissioner contended that the taxpayer could only deduct 1/9 of the amount paid for the supply of the goods and services in the relevant tax period as input tax. The Commissioner considered that the input tax should be limited to the extent of the deposit paid in October 1993 and could not extend to the balance of the purchase price to be paid in a future GST period. This assessment was made on the grounds that section 20(3)(b)(i) limits the deduction of input tax "to the extent that a payment has been made during the taxable period." The taxpayer objected and a case was stated.

Decision: Judge Willy held that the taxpayer was entitled to deduct the total amount of GST paid on the purchase price of the property as an input tax in the GST period immediately following the signing of the contract and the payment of the deposit and the full amount of GST. He considered that the payment of GST at the time of signing the contract was clearly "a payment" within the plain meaning of section 9(1). The time of supply contemplated by section 9(1) was the date the agreement was made and equitable title passed to the purchaser.

Judge Willy rejected the Commissioner's contention that the taxpayer could only deduct 1/9 of the deposit paid as an input tax because this would lead to unjust and absurd results. Judge Willy cited the approach to the interpretation of taxing statutes in *CIR v Alcan New Zealand Limited* (1994) 16 NZTC 11,175. Following this approach, he said that Parliament could not have intended the arbitrary result that a taxpayer registered to pay GST on an invoice basis may deduct the allowable input in the period in which the output is paid, but the payments based taxpayer may not. Judge Willy also noted that if the Commissioner's contention was accepted there was no mechanism for the taxpayer to deduct the remaining 8/9 of the GST paid.

Comment: Inland Revenue is appealing this decision.

Booklets available from Inland Revenue

This list shows all of Inland Revenue's information booklets as at the date of this Tax Information Bulletin. There is also a brief explanation of what each booklet is about.

Some booklets could fall into more than one category, so you may wish to skim through the entire list and pick out the booklets that you need. You can get these booklets from any IRD office.

For production reasons, the TIB is always printed in a multiple of eight pages. We will include an update of this list at the back of the TIB whenever we have enough free pages.

General information

Binding rulings (IR 115G) - May 1995: *Explains binding rulings, which commit Inland Revenue to a particular interpretation of the tax law once given.*

Dealing with Inland Revenue (IR 256) - Apr 1993: *Introduction to Inland Revenue, written mainly for individual taxpayers. It sets out who to ask for in some common situations, and lists taxpayers' basic rights and obligations when dealing with Inland Revenue.*

Inland Revenue audits (IR 297) - May 1995: *For business people and investors. It explains what is involved if you are audited by Inland Revenue; who is likely to be audited; your rights during and after the audit, and what happens once an audit is completed.*

Koha (IR 278) - Aug 1991: *A guide to payments in the Maori community - income tax and GST consequences.*

New Zealand tax residence (IR 292) - Apr 1994: *An explanation of who is a New Zealand resident for tax purposes.*

Objection procedures (IR 266) - Mar 1994: *Explains how to make a formal objection to a tax assessment, and what further options are available if you disagree with Inland Revenue.*

Overseas Social Security Pensions (IR 258) - Sep 1995: *Explains how to account for income tax in New Zealand if you receive a social security pension from overseas.*

Problem Resolution Service (IR 287) - Nov 1993: *An introduction to Inland Revenue's Problem Resolution Service. You can use this service if you've already used Inland Revenue's usual services to sort out a problem, without success.*

Provisional tax (IR 289) - Jun 1995: *People whose end-of-year tax bill is over $2,500 must generally pay provisional tax for the following year. This booklet explains what provisional tax is, and how and when it must be paid.*

Putting your tax affairs right (IR 282) - May 1994: *Explains the advantages of telling Inland Revenue if your tax affairs are not in order, before we find out in some other way. This book also sets out what will happen if someone knowingly evades tax, and gets caught.*

Rental income (IR 264) - Apr 1995: *An explanation of taxable income and deductible expenses for people who own rental property. This booklet is for people who own one or two rental properties, rather than larger property investors.*

Reordered Tax Acts (IR 299) - Apr 1995: *In 1994 the Income Tax Act 1976 and the Inland Revenue Department Act 1974 were restructured, and became the Income Tax Act 1994, the Tax Administration Act 1994 and the Taxation Review Authorities Act 1994. This leaflet explains the structure of the three new Acts.*

Self-employed or an employee? (IR 186) - Apr 1993: *Sets out Inland Revenue's tests for determining whether a person is a self-employed contractor or an employee. This determines what expenses the person can claim, and whether s/he must pay ACC premiums.*

Special tax codes (IR 23G) - Jan 1995: *Information about getting a special "flat rate" of tax deducted from your income, if the regular deduction rates don't suit your particular circumstances.*

Stamp duty and gift duty (IR 665) - Mar 1995: *Explains what duty is payable on transfers of real estate and some other transactions, and on gifts. Written for individual people rather than solicitors and legal firms.*

Student Loan repayments (SL 2) - Jan 1995: *A guide to making student loan repayments.*

Superannuitants and surcharge (IR 259) - Jan 1995: *A guide to the surcharge for national superannuitants who also have other income.*

Tax facts for income-tested beneficiaries (IR 40C) - Sep 1992: *Vital information for anyone who receives an income-tested benefit and also has some other income.*

Taxes and Duties (IR 295) - May 1995: *A brief introduction to the various taxes and duties payable in New Zealand.*

Taxpayer Audit - (IR 298): *An outline of Inland Revenue's Taxpayer Audit programme. It explains the units that make up this programme, and what type of work each of these units does.*

Trusts and Estates - (IR 288) - May 1995: *An explanation of how estates and different types of trusts are taxed in New Zealand.*

Visitors Tax Guide - (IR 294) - Nov 1995: *An explanation of how New Zealand taxes apply to visitors to this country.*

Business and employers

ACC premium rates - Mar 1995: *There are two separate booklets, one for employer premium rates and one for self-employed premium rates. Each booklet covers the year ended 31 March 1995.*

Depreciation (IR 260) - Apr 1994: *Explains how to calculate tax deductions for depreciation on assets used to earn assessable income.*

Employers' guide (IR 184) - 1995: *Explains the tax obligations of anyone who is employing staff, and explains how to meet these obligations. Anyone who registers as an employer with Inland Revenue will receive a copy of this booklet.*

Entertainment Expenses (IR 268) - May 1995: *When businesses spend money on entertaining clients, they can generally only claim part of this expenditure as a tax deduction. This booklet fully explains the entertainment deduction rules.*

Fringe benefit tax guide (IR 409) - Nov 1994: *Explains fringe benefit tax obligations of anyone who is employing staff, or companies which have shareholder-employees. Anyone who registers as an employer with Inland Revenue will receive a copy of this booklet.*

GST - do you need to register? (GST 605) - May 1994 *A basic introduction to goods and services tax, which will also tell you if you have to register for GST.*

GST guide (GST 600) - 1994 Edition: *An in-depth guide which covers almost every aspect of GST. Everyone who registers for GST gets a copy of this booklet. It is quite expensive for us to print, so we ask that if you are only considering GST registration, you get the booklet "GST - do you need to register?" instead.*

IR 56 taxpayer handbook (IR 56B) - Apr 1995: *A booklet for part-time private domestic workers, embassy staff, nannies, overseas company reps and Deep Freeze base workers who make their own PAYE payments.*

PAYE deduction tables - 1996
- Weekly and fortnightly (IR 184X)
- Four-weekly and monthly (IR 184Y)
Tables that tell employers the correct amount of PAYE to deduct from their employees' wages.

Record keeping (IR 263) - Mar 1995: *A guide to record-keeping methods and requirements for anyone who has just started a business.*

Retiring allowances and redundancy payments (IR 277) - Jun 1994: *An explanation of the tax treatment of these types of payments.*

Running a small business? (IR 257) Jan 1994: *An introduction to the tax obligations involved in running your own business.*

Surcharge deduction tables (IR 184NS) - 1994: *PAYE deduction tables for employers whose employees are having national super surcharge deducted from their wages.*

Resident withholding tax and NRWT

Approved issuer levy (IR 291A) - May 1995: *For taxpayers who pay interest to overseas lenders. Explains how you can pay interest to overseas lenders without having to deduct NRWT.*

Interest earnings and your IRD number (IR 283L) - Sep 1991: *Explains the requirement for giving to your IRD number to your bank or anyone else who pays you interest.*

Non-resident withholding tax guide (IR 291) - Mar 1995: *A guide for people or institutions who pay interest, dividends or royalties to people who are not resident in New Zealand.*

Resident withholding tax on dividends (IR 284) - Oct 1993: *A guide for companies, telling them how to deduct RWT from the dividends that they pay to their shareholders.*

Resident withholding tax on interest (IR 283) - Mar 1993: *A guide to RWT for people and institutions which pay interest.*

Resident withholding tax on investments (IR 279) - Apr 1993: *An explanation of RWT for people who receive interest or dividends.*

Non-profit bodies

Charitable organisations (IR 255) - May 1993: *Explains what tax exemptions are available to approved charities and donee organisations, and the criteria which an organisation must meet to get an exemption.*

Clubs and societies (IR 254) - Jun 1993: *Explains the tax obligations which a club, society or other non-profit group must meet.*

Education centres (IR 253) - Jun 1994: *Explains the tax obligations of schools and other education centres. Covers everything from kindergartens and kohanga reo to universities and polytechnics.*

Gaming machine duty (IR 680A) - Feb 1992: *An explanation of the duty which must be paid by groups which operate gaming machines.*

Grants and subsidies (IR 249) - Jun 1994: *An guide to the tax obligations of groups which receive a subsidy, either to help pay staff wages, or for some other purpose.*

Company and international issues

Consolidation (IR 4E) - Mar 1993: *An explanation of the consolidation regime, which allows a group of companies to be treated as a single entity for tax purposes.*

Controlled foreign companies (IR 275) - Nov 1994: *Information for NZ residents with interests in overseas companies. (More for larger investors, rather than those with minimal overseas investments)*

Foreign dividend withholding payments (IR 274A) - Mar 1995: *Information for NZ residents with interests in overseas companies. This booklet also deals with the attributed repatriation and underlying foreign tax credit rules. (More for larger investors, rather than those with minimal overseas investments)*

Foreign investment funds (IR 275B) - Oct 1994: *Information for taxpayers who have overseas investments. (More for larger investors, rather than those with minimal overseas investments).*

Imputation (IR 274) - Feb 1990: *A guide to dividend imputation for New Zealand companies.*

Qualifying companies (IR 4PB) Oct 1992: *An explanation of the qualifying company regime, under which a small company with few shareholders can have special tax treatment of dividends, losses and capital gains.*

Child Support booklets

Child Support - a custodian's guide (CS 71B) - Nov 1995: *Information for parents who take care of children for whom Child Support is payable.*

Child Support - a guide for bankers (CS 66) - Aug 1992: *An explanation of the obligations that banks may have to deal with for Child Support.*

Child Support - a liable parent's guide (CS 71A) - Nov 1995: *Information for parents who live apart from their children.*

Child Support administrative reviews (CS 69A) - Jul 1994: *How to apply for a review of the amount of Child Support you receive or pay, if you think it should be changed.*

Child Support - does it affect you? (CS 50): *A brief introduction to Child Support in Maori, Cook Island Maori, Samoan, Tongan and Chinese.*

Child Support - how to approach the Family Court (CS 51) - Jul 1994: *Explains what steps people need to take if they want to go to the Family Court about their Child Support.*

Child Support - how the formula works (CS 68) - 1996: *Explains the components of the formula for calculating the amount of Child Support payable, and gives up-to-date rates.*

What to do if you have a problem when you're dealing with us (CS 287) - May 1995: *Explains how our Problem Resolution Service can help if our normal services haven't resolved your Child Support problems.*

Due dates reminder

February 1996

5 Large employers: PAYE deductions and deduction schedules for period ended 31 January 1996 due.

7 Provisional tax and/or Student Loan interim repayments: first 1997 instalment due for taxpayers with October balance dates.
Second 1996 instalment due for taxpayers with June balance dates.
Third 1996 instalment due for taxpayers with February balance dates.

Income tax, Student Loans and earner/employer premium - 1995 end-of-year payment due for taxpayers with March-September balance dates.

QCET payments due for companies with March-September balance dates with elections effective from the 1996 income year.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 February 1996 due.

Small employers: PAYE deductions and deduction schedules for period ended 31 January 1996 due.

Gaming machine duty return and payment for month ended 31 January 1996 due.

RWT on interest deducted during January 1996 due for monthly payers.

RWT on dividends deducted during January 1996 due.

Non-resident withholding tax (or approved issuer levy) deducted during January 1996 due.

29 GST return and payment for period ended 31 January 1996 due.

March 1996

5 Large employers: PAYE deductions and deduction schedules for period ended 29 February 1996 due.

7 Provisional tax and/or Student Loan interim repayments: first 1997 instalment due for taxpayers with November balance dates.
Second 1996 instalment due for taxpayers with July balance dates.
Third 1996 instalment due for taxpayers with March balance dates.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 March 1996 due.

Small employers: PAYE deductions and deduction schedules for period ended 29 February 1996 due.

Gaming machine duty return and payment for month ended 29 February 1996 due.

RWT on interest deducted during February 1996 due for monthly payers.

RWT on dividends deducted during February 1996 due.

Non-resident withholding tax (or approved issuer levy) deducted during February 1996 due.

29 GST return and payment for period ended 29 February 1996 due.

31 Fourth instalment of 1996 Student Loan non-resident assessment due.

(We will accept payments received on Monday 1 April as in time for 31 March 1996.)

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