Volume Eight, No.10 December 1996

TAX INFORMATION BULLETIN

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TIB Volume numbers - Volume Nine starts January 1997

Up until now, the TIB volume number has always changed at the end of June each year, simply because the TIB originally started in July 1989.

However, we're going to end Volume Eight at No.11 (December 1996) and start Volume Nine in January 1997. We're doing this to synchronise the volume numbers as closely as possible with the binding ruling numbers, which work on a calendar year basis. It will also make references and filing easier in future years, because each volume number will equate to a calendar year.

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.

Rifles, shotguns, pistols, firearms, fastening guns (explosive) - Depreciation Determination DEP20

In TIB Volume Eight, No.2 (August 1996) at pages 7 - 9, the Commissioner published a draft general depreciation determination for rifles, shotguns, pistols, firearms, and fastening guns (explosive).

Two submissions were received on this draft. The first asked if air rifles and air pistols were to be included in the asset class of "Firearms" in the "Leisure" industry category. The second submission recommended that a new asset class for "paintball firearms" be inserted into the "Leisure" industry category. These issues have been considered, and the Commissioner has now issued the determination, as amended to take account of the above submissions.

The determination is reproduced below, and may be cited as "Determination DEP20: Tax Depreciation Rates General Determination Number 20". The new depreciation rates are based on the EULs set out in the determination below and residual values of 13.5% of cost.

General Depreciation Determination DEP20

This determination may be cited as "Determination DEP20: Tax Depreciation Rates General Determination Number 20".

1. Application

This determination applies to taxpayers who own the asset classes listed below.

This determination applies to "depreciable property" other than "excluded depreciable property" for the 1996/97 and subsequent income years.

2. Determination

Pursuant to section EG 4 of the Income Tax Act 1994 I hereby amend Determination DEP1: Tax Depreciation Rates General Determination Number 1 (as previously amended) by:

- Inserting into the "Agriculture, Horticulture and Aquaculture" industry category the general asset classes, estimated useful lives, and diminishing value and straight-line depreciation rates listed below:

Agriculture, Horticulture and Aquaculture	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Rifles (less than 10,000 rounds per year)	6.66	26	18
Rifles (greater than 10,000 rounds per year)	2	63.5	63.5
Shotguns (less than 50,000 rounds per year)	6.66	26	18
Shotguns (greater than 50,000 rounds per year)	2	63.5	63.5

- Deleting from the "Leisure" industry category the general asset classes, estimated useful lives, and diminishing value and straight-line depreciation rates listed below:

Leisure	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Pistols	10	18	12.5
Rifles	10	18	12.5

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- Inserting into the "Leisure" industry category the general asset class, estimated useful lives, and diminishing value and straight-line depreciation rates listed below:

Leisure	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Firearms	10	18	12.5
Rifles, Air	10	18	12.5
Pistols, Air	10	18	12.5
Paintball firearms	2	63.5	63.5

- Inserting into the "Contractors, Builders and Quarrying" industry category the general asset class, estimated useful life, and diminishing value and straight-line depreciation rates listed below:

Contractors, Building and Quarrying	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Fastening gun (explosive)	3	50	40

- Inserting into the "Timber and Joinery Industries" industry category the general asset class, estimated useful life, and diminishing value and straight-line depreciation rates listed below:

Timber and Joinery Industries	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Fastening gun (explosive)	3	50	40

3. Interpretation

In this determination, unless the context otherwise requires, expressions have the same meaning as in the Income Tax Act 1994.

This determination is signed by me on the 5th day of December 1996

Jeff Tyler
Assistant General Manager (Adjudication & Rulings)

Aquariums - draft depreciation determination

The Commissioner has been made aware that there is currently no depreciation rate for fish aquariums used for display in offices and other business establishments.

The Commissioner proposes to issue a general depreciation determination which will set the asset class for aquariums. The draft determination is reproduced below. The determination will set a new depreciation rate of 40% DV for the asset class "Aquariums". The proposed new depreciation rate of 40% DV is based on an estimated useful life ("EUL") of 4 years and a residual value of 13.5% of cost.

Exposure draft - General Depreciation Determination DEPX

This determination may be cited as "Determination DEPX: Tax Depreciation Rates General Determination Number X".

1. Application

This determination applies to taxpayers who own the asset classes listed below.

This determination applies to "depreciable property" other than "excluded depreciable property" for the 1996-97 and subsequent income years.

2. Determination

Pursuant to section EG 10 (1)(a) of the Income Tax Act 1994 I hereby:

- Issue the special asset class, estimated useful life, and diminishing value and straight-line rate listed below:

Office Equipment and Furniture	Estimated useful life (years)	DV banded dep'n rate (%)	SL equivalent banded dep'n rate (%)
Aquariums	4	40	30

3. Interpretation

In this determination, unless the context otherwise requires, expressions have the same meaning as in the Income Tax Act 1994.

If you wish to make a submission on these proposed new depreciation rates, please write to:

Assistant General Manager
Adjudication & Rulings
National Office
Inland Revenue Department
P O Box 2198
WELLINGTON

We need to receive your submission by 31 January 1997 if we are to take it into account in finalising this determination.

Special banking option for overseas pensions begins 1 April 1997

1 April 1997 has been set as the application date of recent amendments relating to a special banking option for New Zealand residents who receive United Kingdom social security pensions. The date was set by the Income Tax (Alternative Arrangement for Overseas Pensions) Commencement Order 1996 on 25 November 1996.

The special banking option allows overseas pensions to be paid into a special bank account. The money is drawn down by the Department of Social Welfare, and in return the pensioner receives the full New Zealand Superannuation or Veteran's pension.

The Taxation (Remedial Provisions) Act 1996 amended sections CB 5 and OB 1 of the Income Tax Act 1994 so that pensions paid in this way would be treated as source deduction payments and exempted from tax. The date of application was to be fixed by the Governor General by Order in Council.

See TIB Volume Eight, No.11 for further details on these amendments.

Fringe benefit tax - prescribed interest rate decreased to 11.1%

The prescribed rate of interest used to calculate the fringe benefit value of low interest employment-related loans has been decreased to 11.1% for the quarter beginning 1 October 1996. This rate will continue to apply to subsequent quarters until any further adjustment is made.

The prescribed rate, down from 11.5%, is a reflection of the recent fall in market rates.

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.

GST: input tax deductions for finance lease financiers and the appropriate method for section 21 adjustments

Public Ruling - BR Pub 96/11

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

Taxation Laws

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

This Ruling applies in respect of sections 2(1) (definition of "input tax"), 3, 6, 8, 9, 14, 20, and 21 of the Goods and Services Tax Act 1985.

The Arrangement to which this Ruling applies

The Arrangement is the incurring of GST on goods and services acquired for the business of financing, by finance lease financiers who enter into finance leases with customers to finance the purchase or lease of goods. This includes:

- GST incurred on goods the finance lease financier buys and which are the subject of the finance lease between financier and customer (for example, a car purchased from a car dealer and sold by way of hire purchase agreement to the customer). These goods are referred to as "finance lease goods" in the Ruling.
- GST incurred on all other goods and services acquired by the finance lease financier (for example, head office, accounting, and administration goods and services). These goods and services are referred to as "general business goods and services" in the Ruling.

For the purposes of the Ruling, a "finance lease financier" is a person whose business includes a substantial activity (which activity need not be the principal activity of the person) of financing the purchase or lease of goods by customers by way of finance leases. The term "finance lease" is not a legal term. It is a commercial term describing a lease or sale of finance lease goods for a fixed term when the lease rentals or purchase price instalments, and any other payments by the customer to the financier under the finance lease (such as a deposit or residual value payment), relate to the value of the goods and not the value of their use. Under a finance lease, the total amount payable ensures that the financier recovers the capital cost of the goods and makes a commercial return on that capital. In ordinary commercial parlance, and for the purposes of this Ruling, a finance lease includes a hire purchase agreement. However, the Act does not define "finance lease" nor make any mention of whether a hire purchase agreement is included within the term.

A finance lease financier is most likely to be a finance company. It is not intended that the term cover persons who, as an adjunct of their business of selling goods, undertake the provision of finance to customers to encourage sales. However, the term is intended to cover a company whose business consists largely of financing the purchase or lease of goods when that company is in a group of companies for GST purposes. This is notwithstanding the deeming provisions of section 55(7).

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- GST incurred on finance lease goods acquired by a finance lease financier will be deductible as "input tax", as the goods are acquired for the principal purpose of making taxable supplies.
- GST incurred on general business goods and services acquired by a finance lease financier will not be deductible as "input tax", because the principal purpose of acquiring such goods and services will be for making exempt supplies.
- In respect of general business goods and services, if there is a partial taxable use of goods and services for which no input tax claim has been available, section 21(5) will apply. The appropriate method for the finance lease financier to apply in determining the percentage of taxable use of general business goods and services is one of the following:
  - The Time Apportionment Method; or
  - The Profit Derivation Method; or
  - The 10% Fixed Percentage Method.

  The Time Apportionment Method calculates the percentage of taxable and exempt use of the general business goods and services by calculating the percentage of staff time spent on taxable and exempt supplies respectively. Financiers must have records to support the figure they calculate.

  The Profit Derivation Method calculates the percentage of taxable and exempt use of the general business goods and services by calculating the percentage of the financier's gross profit that comes from taxable and exempt supplies respectively. Financiers must have records to support the figure they calculate.

  The 10% Fixed Percentage Method does not involve calculating the percentage of taxable and exempt application of general business goods and services. Instead, it assumes that the general business goods and services are applied 10% in making taxable supplies. This method may be used by financiers for administrative convenience. This method allows financiers to make section 21(5) adjustments without records to support the calculation. It is a method of last resort when financiers do not have records to calculate either of the methods described above.

  A financier may not use the 10% Fixed Percentage Method when records are held that support either of the other two methods, and those records disclose taxable use of below 10%.
- If a section 21 method more accurate than those discussed above exists, it may be used in place of the methods above. Where taxpayers are unclear if the section 21 adjustment method they propose to use is more accurate than those discussed above, they may wish to confirm its appropriateness with their local Inland Revenue office.

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The period for which this Ruling applies

This Ruling will apply for the period from 1 February 1997 to 31 March 2000.

This Ruling is signed by me on the 25th day of November 1996.

Martin Smith
General Manager (Adjudication & Rulings)

Commentary on Public Ruling BR Pub 96/11

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 96/11 ("the Ruling").

Background

For more discussion on the GST treatment of finance leases generally refer to the policy statement entitled *"GST and finance leases - classification, method of accounting and treatment of residual value clause"* in TIB Volume Eight, No. 1 (July 1996) at page 1. This ruling and that policy statement are consistent and should be considered together.

Legislation

Section 2 defines "input tax". Generally, "input tax" is the tax charged on supplies of goods and services made to a registered person when the supplies are acquired for the principal purpose of making taxable supplies.

Section 6(1) defines "taxable activity". A taxable activity is any activity carried on continuously or regularly, whether for pecuniary profit or not, and involves the supply of goods and services to other persons for consideration.

Section 8(1) imposes GST on the supply (other than an exempt supply) of goods and services, in New Zealand, by a registered person in the course or furtherance of a taxable activity carried on by that person.

Section 3(1) states:

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

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

(f) The provision of credit under a credit contract:..

Section 14 states:

The following supplies of goods and services shall be exempt from tax:

(a) The supply of any financial services (together with the supply of any other goods and services, supplied by the supplier of those financial services, which are reasonably incidental and necessary to that supply of financial services), not being-

...

(ii) A supply of goods and services which (although being part of a supply of goods and services which, but for this subparagraph, would be an exempt supply under this paragraph) is not in itself, as between the supplier of that first-mentioned supply and the recipient, a supply of financial services in respect of which this paragraph applies:...

Section 9 determines the time at which any supply takes place. Section 9(1) states the general rule - it deems a supply to take place at the earlier of the time the supplier issues an invoice or receives a payment for that supply. The remaining subsections of section 9 provide exceptions to this general rule. Section 9(3) states:

Notwithstanding anything in subsection (1) or subsection (2) of this section,-

(a) Where goods are supplied under an agreement to hire...they shall be deemed to be successively supplied for successive parts of the period of the agreement ... , and each of the successive supplies shall be deemed to take place when a payment becomes due or is received, whichever is the earlier:

...

(b) Where goods and services are supplied under a hire purchase agreement (as defined in the Hire Purchase Act 1971), that supply shall be deemed to take place at the time the agreement is entered into:

(c) For the purposes of this subsection, the term "agreement to hire" means an agreement for the bailment of goods for hire and includes a lease of goods and a rental agreement; but does not include-

(i) An agreement under which the property in the goods passes to the bailee or which expressly contemplates that the property in the goods will pass to the bailee; or

(ii) A hire purchase agreement (as defined in the Hire Purchase Act 1971).

Section 20(3) allows for the deduction of input tax from amounts of output tax.

Section 21 states:

(1) Subject to section 5(3) of this Act, to the extent that goods and services applied by a registered person for the principal purpose of making taxable supplies are subsequently applied by that registered person for a purpose other than that of making taxable supplies, they shall be deemed to be supplied by that registered person in the course of that taxable activity to the extent that they are so applied:..

...

(5) For the purposes of this Act, where no deduction has been made pursuant to section 20(3) of this Act in respect of or in relation to goods and services acquired or produced ... by a person other than for the principal purpose of making taxable supplies, and any such goods and services are subsequently applied in any taxable period by that person...those goods and services shall be deemed to be supplied in that taxable period to that person...and the Commissioner shall, to the extent to which those goods and services are so applied, allow that person...to make a deduction under section 20(3) of this Act...

Application of the Legislation

Output tax on supplies made by finance lease financiers

Finance lease financiers make both taxable and exempt supplies pursuant to finance leases (unless they are only receiving assignments of hire purchase or other finance leases from retailers in which case the whole transaction is exempt, section 3(1)(c)).

The taxable supply is the supply of goods pursuant to the finance lease. The supply of goods is a taxable supply because the financier's activity of selling or leasing goods is within the definition of "taxable activity" in section 6(1)(a) and is subject to GST under section 8(1).

A financier's taxable supply of goods is not "reasonably incidental and necessary" to the exempt supply of financial services in terms of section 14(a). A financier does not make a supply of goods "reasonably incidental and necessary" to the supply of credit. The significant value and volume of the goods supplied and the effort incurred in dealing in the goods suggest that the goods are not reasonably incidental and necessary to the supply of credit in the sense intended by section 14(a). Furthermore, the words of section 14(a) that make some supplies exempt supplies if they are "reasonably incidental and necessary" to a supply of financial services came about as a result of the Court of Appeal decision in the *Databank* litigation. The amendment was intended to cover supplies that were truly incidental and minor to a supply of financial services, rather than the situation with finance lease financiers who sell or lease goods to such a degree that they are sufficient to be significant supplies in their own right.

Therefore, finance lease financiers must account for GST output tax on their supplies of goods. For hire purchase agreements a financier must return output tax in the same taxable period as the input tax deduction, because of the time of supply rule in section 9(3)(b) and the section 20(3) rules on input tax deductions. However, for agreements to hire the time of supply rules in section 9(3)(a) apply, and for other finance leases the general time of supply rule in section 9(1) may apply. See the discussion of time of supply rules in *"GST and finance leases - classification, method of accounting and treatment of residual value clause"* TIB Volume Eight, No. 1 (July 1996) for further discussion of these points.

The supply of credit is an exempt supply under section 3(1)(f). Therefore, finance lease financiers do not need to account for GST on their supplies of credit.

Input tax on goods and services acquired by finance lease financiers

For GST to be deductible as input tax, it must be on goods and services acquired for the principal purpose of making taxable supplies. The definition of "input tax" means that whether GST is deductible as input tax is an all-or-nothing test: either GST is fully deductible as input tax or it is not deductible at all. There can be no partial deduction as input tax.

Principal purpose of acquiring finance lease goods is for making taxable supplies

GST on finance lease goods acquired by a finance lease financier will be deductible as "input tax" as the goods are acquired for the principal purpose of making taxable supplies. The goods are acquired with the purpose of selling or leasing them to the customer, a taxable supply. For example, when a hire purchase financier buys a car from a dealer for sale to a customer, that sale to the customer, pursuant to a finance lease, is a taxable supply.

Principal purpose of acquiring general business goods and services is for making exempt supplies

A finance lease financier's principal purpose of acquiring general business goods and services is for making exempt supplies. It is the supply of credit that generates income, more so than the supply of goods. This means the principal purpose of acquiring general business goods and services is to make exempt supplies; *CIR v BNZ Investment Advisory Services* (1994) 16 NZTC 11,111. Therefore, the tax charged on the general business goods and services is not "input tax" and no deduction is available under section 20(3).

In the *BNZ Investment Advisory Services* case the taxpayer offered investment advice to customers for which a small charge was made (taxable supplies). The taxpayer also collected a commission on any investment subsequently made through it by those customers (exempt supplies). For the periods in question, income from advice was minor compared to commission income. In carrying on its taxable activity, the taxpayer acquired goods and services and sought to deduct the GST on them, claiming its principal purpose in so acquiring was to make taxable supplies of investment advice. The Commissioner considered the principal purpose of acquiring such goods and services was to make a profit from its business. The taxpayer's business income was almost totally earned from commissions, that is, earned from making exempt supplies. The High Court found for the Commissioner. Doogue J considered the principal purpose of the taxpayer in acquiring the goods and services was not for a single goal of offering investment advice to customers, but for the purpose of

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achieving income from GST-exempt services (page 11,117 of the judgment). Accordingly, the GST was not deductible as input tax.

The conclusion that GST on general business goods and services acquired by a financier is not "input tax" derives further support from the United Kingdom's VAT position. In an agreement between the UK Customs & Excise and the UK Finance Houses Association Ltd, for the purposes of agreeing a level of partial exemption, the parties agreed that only 15% of the input tax on goods and services used in providing hire purchase credit related to taxable supplies. Thus in the UK, where a partial input tax deduction is possible, the authorities and trade body were both of the view that the principal purpose of hire purchase financiers acquiring general business goods and services was for making exempt supplies.

The financier can not make input tax deductions on general business goods and services, because general business goods and services are not acquired for the principal purpose of making taxable supplies.

Section 21 adjustments

If a registered person who applies goods and services for the principal purpose of making taxable supplies subsequently applies those goods and services for making other than taxable supplies, a section 21(1) adjustment is required. There will be a deemed taxable supply to the extent of the application to non-taxable supplies.

When the principal purpose of acquiring or producing goods and services is to make non-taxable supplies, and the goods and services are subsequently applied to making taxable supplies, section 21(5) allows a deduction from output tax to the extent to which those goods and services are so applied. The section 21(5) adjustment is based on the lesser of the cost of the goods and services or the open market value of the supply of those goods and services.

Section 21(5) adjustment methods are intended to measure the taxable use of goods and services acquired for making non-taxable supplies.

Application of section 21 to finance lease financiers

Finance lease financiers do not need to make section 21(1) adjustments for finance lease goods as the goods are used solely in making taxable supplies. For example, if a financier acquires a car from a dealer and then sells it to a customer pursuant to a hire purchase agreement, the supply of the car is a taxable supply without any exempt application.

However, a finance lease financier may need to make section 21(5) adjustments for general business goods and services if the general business goods and services are applied to making exempt supplies of credit and also taxable supplies of goods (there are no taxable supplies of goods when the financier simply receives an assignment of a hire purchase agreement from a retailer). For example, a financier should make a section 21(5) adjustment when applying a computer system for recording details of the taxable supply of goods, and also for the ongoing monitoring of the credit contract.

The issue then arises as to how the percentage of exempt and taxable use, which will form the basis of the section 21(5) adjustment, should be measured.

Section 21 adjustment methods: standard methods

Whatever method is adopted to make section 21(5) adjustments, that method should, as accurately as possible, reflect the extent to which general business goods and services are applied in making taxable and non-taxable supplies. The registered person should adopt a method that correctly reflects the application of the general business goods and services.

The Commissioner has identified the following adjustment methods for general use (see the GST Guide - GST 600, or Technical Rulings 110.4). They are:

- Direct Attribution Method; or
- Turnover Method; or
- A special method.

If the Direct Attribution or Turnover Methods are not well suited to a specific case, a special method should be used.

The Commissioner considers that neither the Direct Attribution nor the Turnover Method is a suitable method for a finance lease financier to use.

The Direct Attribution Method allocates individual goods and services to taxable or non-taxable supplies on the basis of actual use. Direct Attribution requires the individual goods and services to be applied exclusively in making a taxable or non-taxable supply. When particular general business goods and services are applied to make both taxable and non-taxable supplies (as may often be the case with a finance lease financier), it is not appropriate to use the Direct Attribution Method.

If it is not appropriate to use the Direct Attribution Method, a registered person may use the Turnover Method. This calculates taxable and non-taxable use of general business goods and services by dividing the total value of exempt supplies by the total value of all supplies. The figure that results from this calculation is the percentage of supplies that are exempt. (This figure is then used to determine the appropriate section 21 adjustment.)

In the finance lease situation, the Turnover Method does not accurately reflect the application of the general business goods and services in making taxable and exempt supplies. The high value of goods supplied under finance leases, and the consequent high gross value of taxable supplies, means the Turnover Method gives a high percentage of taxable supplies relative to

exempt supplies. In reality, the general business goods and services are applied for making taxable supplies for only a small percentage of their use. Any taxable use generally requires little time or effort. The general business goods and services are applied mainly in making exempt supplies of credit.

As the Direct Attribution and Turnover Methods are unsuitable methods for finance lease financiers to use, such financiers should use a special method. (There are many possible special methods, the three most appropriate methods for finance lease financiers are discussed below.)

Appropriate special methods

There are at least three appropriate section 21(5) adjustment methods finance lease financiers may use in calculating the adjustment for general business goods and services. They are:

- The Time Apportionment Method; or
- The Profit Derivation Method; or
- The 10% Fixed Percentage Method.

The Time Apportionment Method calculates the percentage of taxable and exempt use of the general business goods and services by calculating the percentage of staff time spent on taxable and exempt supplies respectively. This gives a better reflection of the mixed use of general business goods and services than the Turnover Method because it focuses on the reality of the business earning income from exempt supplies. Financiers must have records to support the figure they calculate.

Use of such a method does not conflict with the *BNZ Investment Advisory Services* decision. In that case the High Court rejected use of a "time and effort" approach to determine the principal purpose of acquiring goods and services, because such an approach was completely different to the way the company earned income through the making of exempt supplies. It confused the means by which the taxpayer achieved its purpose (time largely spent on making taxable supplies) with its purpose (earning income from exempt supplies). Here the purpose of earning income from exempt supplies and use of a time and effort method will be consistent, as both the majority of income and the majority of time and effort relate to exempt supplies.

The Profit Derivation Method calculates the percentage of taxable and exempt use of the general business goods and services by calculating the percentage of the financier's gross profit that comes from taxable and exempt supplies respectively. This gives a better reflection of the mixed use of general business goods and services than the Turnover Method because it reflects the importance of the particular supplies in earning the income that is the purpose of undertaking finance lease financing. Financiers must have records to support the figure they calculate. The Profit Derivation Method requires a profit to be made from the on-sale of the car to the customer, rather than from normal credit charges.

The 10% Fixed Percentage Method does not involve calculating the percentage of taxable and exempt application of general business goods and services. Instead, it assumes that the general business goods and services are applied 10% in making taxable supplies. The Commissioner will allow use of this method by financiers for administrative convenience. This method allows financiers to make section 21(5) adjustments without records to support the calculation. As suggested by empirical evidence and the UK VAT agreement discussed above, this gives an appropriate reflection of the mixed use of general business goods and services because it is a reasonable estimate of taxable use. If financiers have good evidence of higher taxable use of general business goods and services, the Commissioner may accept a higher figure for section 21(5) purposes.

A financier may not use the 10% Fixed Percentage Method when records are held that support either of the other two methods, and those records disclose taxable use of below 10%.

When a section 21 method more accurate than those discussed above exists, it may be used in place of the methods above. If taxpayers are unclear as to whether the section 21 adjustment method they propose to use is more accurate than those discussed above, they may wish to confirm its appropriateness with their local Inland Revenue office.

Examples

Example 1

Company A finances the acquisition of motor vehicles. Over the last twelve months it has bought and on-sold $10,500,000 worth of motor vehicles under hire purchase agreements. Over the same period it earned $1,700,000 in net interest income from its financing activity. It earns no profit from the sale of motor vehicles. Company A has a staff of 25. The majority of the staff are involved in the credit side of the business. However, one staff member is employed solely in the inspection and sale of motor vehicles. Another staff member, spends about 50% of her time assisting in the inspection and sale of motor vehicles. Company A takes a full input tax deduction for cars it buys and then sells to customers (finance lease goods), but wants to know the appropriate way to account for GST on general business goods and services it acquires.

Company A can not deduct the GST on general business goods and services as "input tax". However, it may make a section 21(5) adjustment because of partial taxable application of the general business goods and services.

If Company A adopts the Time Apportionment Method, taxable use will amount to 6% of the general business goods and services (1.5 employees out of 25 employees). Therefore, exempt use will amount to 94% of the general business goods and services.

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Applying the Profit Derivation Method would give a figure of 0% taxable use and 100% exempt use. This method does not best reflect the actual application of the general business goods and services.

Company A cannot make a section 21(5) adjustment for 10% taxable use using the 10% Fixed Percentage Method as it has records supporting one of the other methods. Therefore, it makes a section 21(5) adjustment for the 6% taxable use of the general business goods and services on the basis of the Time Apportionment Method.

Example 2

Company B is a finance company that receives assignments of hire purchase agreements from retailers. Company B may not make any input tax deduction. The assignment of the hire purchase agreement is an exempt supply of a financial service, on which there is no GST. Company B makes no taxable supplies, so it may not make any input tax deduction for GST charged on goods and services supplied to its business.

GST: time of supply when payment is made by cheque, credit card, charge card or irrevocable letter of credit

Public Ruling - BR Pub 96/12

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

Taxation Law

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

This Ruling applies in respect of section 9(1) of the Goods and Services Tax Act 1985.

The Arrangement to which this Ruling applies

The Arrangement is the supply of goods and services by a supplier to a recipient when the recipient pays by cheque, credit card, or charge card and no invoice has been issued by the supplier or recipient before payment.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- When payment for a supply is received by the supplier in the form of a cheque, “payment” occurs for the purposes of section 9(1) when the cheque is handed over or received, unless the cheque is subsequently dishonoured. If the cheque is dishonoured, “payment” has never occurred. This rule applies equally to post-dated cheques.
- If the supplier and recipient are associated persons, the Commissioner will need from the supplier as evidence of payment, details of the cheque’s presentation and honouring by the bank on which it is drawn,
- When the supplier receives payment for a supply by means of a credit or charge card, “payment” occurs for the purposes of section 9(1) on the date the credit or charge card transaction takes place.
- When the supplier accepts payment for a supply by way of an irrevocable letter of credit, “payment” occurs for the purposes of section 9(1) on the date the provision of the letter of credit is accepted as performance or payment.

The period for which this Ruling applies

This Ruling will apply for the period 1 January 1997 to 31 December 1999 to payments that are received by GST registered persons during that period for the supply of goods and services.

This Ruling is signed by me on the 29th day of November 1996.

Martin Smith
General Manager (Adjudication & Rulings)

Commentary on Public Ruling BR Pub 96/12

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 96/12 ("the Ruling").

Legislation

Section 9(1) states:

Subject to this Act, for the purposes of this Act a supply of goods and services shall be deemed to take place at the earlier of the time an invoice is issued by the supplier or the recipient or the time any payment is received by the supplier, in respect of that supply.

"Payment" is not defined in the Goods and Services Tax Act 1985.

Section 9(2)(a) provides a special time of supply rule for associated persons in certain circumstances. Section 9(2) states:

Notwithstanding anything in subsection (1) of this section, a supply of goods and services shall be deemed to take place-

(a) Where the supplier and the recipient are associated persons,-

(i) In the case of a supply of goods which are to be removed, at the time of the removal; and

(ii) In the case of a supply of goods which are not to be removed, at the time when they are made available to the recipient; and

(iii)In the case of a supply of services, at the time the services are performed:

Provided that this paragraph shall not apply in any case where an invoice is issued, or any payment is made, in respect of that supply, on or before the last day for furnishing the return in relation to the taxable period during which, but for this proviso, that supply would have been made:

Section 2 defines "Associated persons":

"Associated persons" has the meaning assigned to that term by section OD 8 (4) of the Income Tax Act 1994; and includes-

(a) Any 2 persons, one of whom is trustee of a trust under which the other has benefited or is eligible to benefit, except where, in relation to a supply of goods and services, -

(i) The trustee is a charitable or non-profit body with wholly or principally charitable, benevolent, philanthropic, or cultural purposes; and

(ii) The supply is made in carrying out those purposes:

(b) Any 2 persons who are relatives as defined in paragraph (a) of the definition of that term in section OB 1 of the Income Tax Act 1994.

(c) Any company and any person where the person is associated with another person who is associated with the company:

Provided that, for the purposes of this Act, any reference to the words "25 percent" in section OD 8 (4) of the Income Tax Act 1994 shall be deemed to be a reference to the words "10 percent":

Application of legislation

Cheques

The issue of payment by cheque has not been considered by the New Zealand courts in the context of GST. However, the courts have considered the issue in the income tax context. They have held that payment is made at the time a cheque is handed over or received, rather than when it is presented at the bank and honoured. A cheque that is subsequently dishonoured is treated as if payment were never made.

The authorities on when a cheque is payment were reviewed in *Nicks Ltd v Taylor Ltd* [1962] NZLR 286. Hardie Boys J accepted the proposition that the giving of a cheque for a debt is payment conditional on the cheque being met, and if the cheque is met it is an actual payment ab initio, that is, from the moment it is delivered.

Payment by cheque was also considered by the High Court in *Ullrich v C of IR* [1964] NZLR 386. At page 388 Perry J said:

When a cheque is handed over in payment can that be regarded as a payment to the person receiving the cheque? My view is that if the course of dealing between the parties contemplates a payment which may be by cheque then the handing over of a cheque would be payment on the date of handing over.

There is a line of English VAT Tribunal decisions that supports the contrary view that a payment by cheque is received only when it is presented and met by the recipient's bank. The VAT cases are considered to over-emphasise the need for physical cash funds to be available, and they ignore the fact that the scheme of the Act creates a time of supply well before a cheque is even written out or handed over, i.e. when an invoice is issued. The Commissioner does not consider that the VAT decisions should be followed in New Zealand.

The New Zealand case law on payment by cheque is based on general legal principles. Nothing in section 9(1) indicates that payment by cheque should occur at a later time in the context of GST.

Cases such as *L67* (1989) 11 NZTC 1,391 and *N24* (1991) 13 NZTC 3,199 have indicated that normal commercial contingencies do not delay the time of supply for GST purposes, and provide further support for the view that payment occurs when a cheque is handed over. In addition to holding that a deposit is "any payment" and sufficient to trigger the time of supply for the whole of the value of the supply, *Case L67* determined that payment occurred on the day of the auction when the contract was signed and the deposit handed over.

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Post-dated cheques

A post-dated cheque is an instrument that bears a date later than the date of its issue. Under section 13(2) of the Bills of Exchange Act 1908, a cheque is not invalid by reason only that it is post-dated.

The Court of Appeal in *Pollock v BNZ* [1901] 20 NZLR 174 considered the effect of a post-dated cheque. At page 182 the Court held that:

> By section 13 of "The Bills of Exchange Act, 1883", the post-dating of a bill of exchange does not invalidate the instrument. It is in effect a bill of exchange payable on demand with a post-date upon which demand is to be made.

Because post-dated cheques are cheques under the Bills of Exchange Act 1908, the Commissioner's view is that they should be subject to the same rules as cheques that are not post-dated. This means that if a post-dated cheque is accepted by a supplier, "payment" occurs for the purposes of section 9(1) at the time the post-dated cheque is handed over or received. (The supplier must account for output tax on this date.) A post-dated cheque that is subsequently dishonoured is treated as if payment were never made.

Irrevocable letters of credit

The principles applied above are further supported by the recent decision in *Case S99* (1996) 17 NZTC 7,622 which dealt with the timing of a payment for a building's sale and purchase made by irrevocable letter of credit. In that case Willy DJ held that the time of payment was when the letter of credit was provided and the offer became unconditional, rather than six months later when the letter of credit was honoured. The letter was unconditional, irrevocable, and extinguished the vendor's rights to recover payment from the purchaser. These rights were replaced with rights "only against the bank".

This case is not being appealed by the Commissioner.

"Payment" will occur when a supplier accepts an irrevocable letter of credit as performance or payment. This is consistent with the treatment of payments made by other instruments, as that is the point in time when the supplier's rights against the purchaser are extinguished or suspended.

Associated persons

Section 9(2)(a) provides a special time of supply rule for associated persons in certain circumstances. When the associated persons' deemed time of supply rule in section 9(2)(a) does not apply, the above rules on cheques and post-dated cheques apply. For the purposes of section 9(1) and 9(2)(a), "payment" occurs when the cheque is handed over or received. If the cheque is subsequently dishonoured, "payment" has never occurred.

However, if the supplier and recipient are associated persons, the Commissioner will need from the supplier as evidence of payment, details of the cheque's presentation and honouring by the bank on which it is drawn. This is merely to provide evidence of the transaction occurring in an arm's length fashion, consistent with the intent of section 9(2)(a). It does not alter the timing of the "payment" from rules applying to third parties.

Credit and charge cards

When a credit or charge card is used to purchase goods and services, the customer tenders the card as a means of payment. The retailer takes details of the customer's card and the purchase. The customer, the retailer, and the credit or charge card issuer receive a copy of a form containing these details. The retailer's account is credited by the issuer with the amount of the purchase, less any discount agreed upon. A statement is sent by the card issuer to the customer, who pays the amount of the invoices.

The Commissioner's view is that when goods and services are supplied by a supplier and the recipient pays by credit or charge card, "payment" occurs for the purposes of section 9(1) on the date the credit or charge card transaction takes place. This is the only time at which payment can occur. Once the supplier has accepted the credit or charge card and completed the sales voucher, the recipient is absolutely discharged from any liability to pay the supplier for those goods or services.

This position is supported by the English Court of Appeal decisions in *Re Charge Card Services Ltd* [1988] 3 All ER 702 and *Customs and Excise Commissioners v Diners Club Ltd and another* [1989] 2 All ER 385. At page 393 of the *Diners Club* decision Woolf LJ said:

> As counsel for the taxpayer companies accepts, that decision (Woolf LJ is referring to the earlier decision in *Re Charge Card Services Ltd*) is binding authority that where a card is produced by a cardholder and accepted by a retailer and the cardholder signs the sales voucher the cardholder is unconditionally discharged from liability to pay to the retailer the amount of the cost of the goods and services.

Other references to "payment"

The principles discussed above, in relation to when "payment" occurs for time of supply purposes, apply equally to the issue of when "payment" occurs for the purpose of input tax deductions made under sections 20(3)(a)(ia) and 20(3)(b)(i), dealing respectively with secondhand goods input tax deductions and payments or hybrid basis deductions for input tax to the extent that payment has been made.

Examples

In the following examples the GST registered persons account for GST on a payments basis. Regardless of the accounting basis, an input tax deduction cannot be claimed unless the requirements of section 20(2) are met.

Example 1

A GST registered retailer owns a dress shop. On 28 July 1996:

- A customer purchases a dress for $600 and pays by cheque.
- The retailer buys 50 new clothes hangers from A Ltd. She pays by cheque. The cheque is for $200 and is post-dated for 3 August 1996.

The retailer's taxable period ends on 31 July 1996. At 31 July 1996, she has not banked the cheque for $600 received for the dress on 28 July 1996. A Ltd's taxable period also ends on 31 July 1996. At 31 July, A Ltd has not banked the cheque post-dated for 3 August 1996.

For the purposes of section 9(1), "payment" occurs when a cheque is handed over or received, provided the cheque is subsequently honoured. The GST implications are as follows:

- The retailer must account for output tax on the $600 she received for the dress, even though she has not banked the cheque.
- The retailer can deduct input tax in respect of the $200 paid to A Ltd, even though the cheque is post-dated for 3 August 1996 and has not been honoured.
- A Ltd must account for output tax on the $200 received for the clothes hangers, even though the cheque is post-dated for 3 August 1996.

Example 2

The facts are the same as in Example 1, except that the retailer's bank informs her on 7 August 1996 that the cheque written by the customer for $600 on 28 July 1996 has been dishonoured.

Because the cheque has been dishonoured, payment has never occurred.

If at 7 August 1996 the retailer has not submitted her GST return for the taxable period ended 31 July 1996, she should ignore the cheque. The retailer does not need to account for output tax on the $600 received for the dress.

If at 7 August 1996 the retailer has submitted her GST return for the taxable period ended 31 July 1996, she should amend the output tax accounted for by notifying the Commissioner in writing, or issue the Commissioner with a Notice of Proposed Adjustment (see page 17 of TIB Volume Eight, No.3 (August 1996)).

Example 3

A GST registered retailer owns a lawn mower shop. On 8 August 1996:

- A customer buys a lawn mower for $800 and pays by credit card.
- The retailer buys 10 metres of astro turf from C Ltd for a window display. The astro turf costs $170, and the retailer pays with the business's credit card.

The retailer's and C Ltd's taxable periods end on 31 August 1996.

For the purposes of section 9(1), payment occurs on the date of the relevant transaction, i.e. 8 August 1996. The GST implications are as follows:

- The retailer must account for output tax on the $800 received for the lawn mower in the taxable period ending 31 August 1996.
- C Ltd must account for output tax on the $170 received for the astro turf in the taxable period ending 31 August 1996.
- The retailer can deduct input tax on the $170 in the taxable period ending 31 August 1996.

Associated non-profit bodies - $1,000 income tax exemption

Public Ruling - BR Pub 95/1A

Note *(not part of ruling): Public ruling BR Pub 95/1 (see TIB Volume Seven, No.2 [August 1995] at page 4) concerned section CB 4 (1)(k) of the Income Tax Act 1994. Section 10(3) of the Taxation (Core Provisions) Act 1996 repeals section CB 4 (1)(k), with effect from the 1997-98 income year. Section 91G(1) of the Tax Administration Act 1994 states that when a taxation law that is the subject of a binding ruling is repealed, the ruling ceases to apply to the extent of, and from the effective date of, that repeal. This means that public ruling BR Pub 95/1 will not apply to the 1997-98 income year and subsequent income years, but will apply to the 1995-96 and 1996-97 income years.*

Public ruling BR Pub 95/1A replaces public ruling BR Pub 95/1 with effect from the 1997-98 income year. It is intended that the cessation of public ruling BR Pub 95/1 and its replacement by public ruling BR Pub 95/1A should have no practical effect on the application of the taxation law contained in the rulings to the relevant taxpayers.

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

Taxation Law

All legislative references are to the Income Tax Act 1994 as amended by the Taxation (Core Provisions) Act 1996 unless otherwise stated.

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This Ruling applies in respect of section DJ 17 of the Income Tax Act 1994.

The Arrangement to which this Ruling applies

The Arrangement is the claiming by a non-profit body associated with a national or principal organisation ("associated non-profit body") of a deduction under section DJ 17 of the lesser of $1,000 or the body's net income.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

The tax deduction under section DJ 17 for the lesser of $1,000 or a body's net income is available to associated non-profit bodies which are separately identifiable taxable entities and which satisfy the other requirements of section DJ 17.

The period for which this Ruling applies

This Ruling will apply to income derived by an associated non-profit body during the period of the 1998 income year, and applies regardless of the taxpayer's balance date.

This Ruling is signed by me on the 8th day of December 1996.

Jeffrey Tyler
Assistant General Manager (Adjudication & Rulings)

Commentary on Public Ruling BR Pub 95/1A

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusion reached in Public Ruling BR Pub 95/1A ("the Ruling").

The subject matter covered in the Ruling was previously dealt with in Public Ruling BR Pub 95/1 (TIB Volume Seven, No.2 (August 1995) at page 4 under the heading "Associated non-profit bodies - $1,000 income tax exemption"). The Ruling replaces and supersedes that earlier ruling with effect from the 1997-98 income year.

Background

The former section CB 4 (1)(k) of the Income Tax Act 1994 provided that non-profit bodies were eligible for a $1,000 income tax exemption. This section was repealed by the Taxation (Core Provisions) Act 1996, and section DJ 17 was enacted in its place. The repeal of section CB 4 (1)(k) and the enactment of section DJ 17 are a change in mechanism only and involve no change to the actual tax position of non-profit bodies.

Generally, the income of a non-profit body is subject to income tax. Non-profit bodies can claim a deduction under section DJ 17 for the lesser of $1,000 or the amount that would be the net income of the body, in the absence of that section.

Types of organisations which may be eligible to claim the tax deduction under section DJ 17 are:

- Trade associations.
- Progressive associations.
- Political parties.
- Social clubs (including those amateur sports bodies that do not qualify for an income tax exemption under section CB 4 (1)(h)).

Legislation

Cross-reference table

Income Tax Act 1994[1]	Income Tax Act 1994[2]	Income Tax Act 1976
CB 4 (1)(h)	CB 4 (1)(h)	61(30)
DJ 17	CB 4 (1)(k)	61(34)

1. as amended by the Taxation (Core Provisions) Act 1996
2. prior to amendment by the Taxation (Core Provisions) Act 1996

Section DJ 17 states:

Any society, association, or organisation, whether incorporated or not, which is not carried on for the purposes of profit or gain to any proprietor, member, or shareholder and which is, by the terms of its constitution, rules, or other document constituting that society, association, or organisation or governing its activities, prohibited from making any distribution, whether by way of money, property, or otherwise, to any such proprietor, member, or shareholder, is allowed a deduction for an amount equal to the lesser of -

(a) $1,000; or

(b) The amount that would be the net income of the society, association or organisation but for this section.

Application of the Legislation

Under section DJ 17, a tax deduction of up to $1,000 is available in any income year to those non-profit bodies that meet the criteria set out in that section.

For an organisation to qualify for the section DJ 17 deduction, the organisation must not be carried on for the profit or gain of any member, and its constituting document must prohibit the organisation from making any distribution whether by way of money, property, or otherwise to its members or persons associated with the members.

Associated non-profit bodies are also eligible for the section DJ 17 deduction

Section DJ 17 may also apply to bodies that are associated with a national or principal non-profit organisation (referred to in the Ruling as "associated non-profit body/ies"). It is not possible to define exactly what an associated non-profit body is for the purposes of the Ruling, but examples are regional or district branches of a national office. The fact that an associated non-profit body shares its constituting document with other "aligned" or "group" organisations does not prevent the section DJ 17 deduction from applying to it, provided its constituting documents meet the relevant criteria set out in DJ 17 and it is able to demonstrate that it is a separately identifiable taxable entity.

Whether an associated non-profit body can be identified as a separately identifiable taxable entity is a question of fact, and each case must be considered on its own facts. The Commissioner considers that an associated non-profit body will be a separately identifiable taxable entity if, for example:

- It keeps separate financial statements; and
- It keeps separate records of receipts and payments; and
- Its activities are not just incidental to the national or principal body's activities; and
- It is situated in a geographical setting that is distinct from the national or principal body.

In addition to these characteristics, section DJ 17 requires that:

- The associated non-profit body is not carried on for the purposes of profit or gain to any proprietor, member, or shareholder; and
- The constituting documents of the associated non-profit body prohibit the organisation from making any distribution, whether by way of money, property, or otherwise, to any proprietor, member, or shareholder of the organisation.

Relationship between the "unit trust" and "qualifying trust" definitions

Public Ruling - BR Pub 95/5A

***Note** (not part of ruling): Public ruling BR Pub 95/5 (see TIB Volume Seven, No.5 [November 1995] at page 5) concerned, in part, the definition of "qualifying trust" in section OB 1 of the Income Tax Act 1994. Section 412(2) of the Taxation (Core Provisions) Act 1996 amends section OB 1 and replaces the definition of "qualifying trust" with effect from the 1997-98 income year. Section 91G(2) of the Tax Administration Act 1994 states that where a taxation law that is the subject of a binding ruling is amended, or repealed in part only, in a manner that alters the way in which the taxation law applies, the ruling ceases to apply to the extent of, and from the effective date of, the amendment or partial repeal. This means that public ruling BR Pub 95/5 will not apply to unit trusts which are created in the 1997-98 income year and subsequent income years. It will apply to such trusts that are created in the 1996-97 income year.*

Public ruling BR Pub 95/5A replaces public ruling BR Pub 95/5 with effect from the 1997-98 income year. It is intended that the cessation of public ruling BR Pub 95/5 and its replacement by public ruling BR Pub 95/5A should have no practical effect on the application of the taxation law contained in the rulings to the relevant taxpayers.

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

Taxation Law

All legislative references are to the Income Tax Act 1994 as amended by the Taxation (Core Provisions) Act 1996 unless otherwise stated.

This Ruling applies in respect of the definitions of "qualifying trust" and "unit trust" in section OB 1 and the definition of "trust rules" in section OZ 1, of the Income Tax Act 1994.

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The Arrangement to which this Ruling applies

The Arrangement is the creation of trusts that are "unit trusts" for the purposes of the Income Tax Act.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

Trusts that fall within both the definition of "qualifying trust" and the definition of "unit trust" in the Income Tax Act 1994 are excluded from the "trust rules".

The period for which this Ruling applies

This Ruling will apply for the period from the 1997-98 income year to the 1999-2000 income year.

This Ruling is signed by me on the 8th day of December 1996.

Jeffrey Tyler
Assistant General Manager (Adjudication & Rulings)

Commentary on Public Ruling BR Pub 95/5A

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusion reached in Public Ruling BR Pub 95/5A ("the Ruling").

The subject matter covered in the Ruling was previously dealt with in Public Ruling BR 95/5 (in TIB Volume Seven, No.5 (November 1995) at page 5 under the heading *Relationship between the "unit trust" and "qualifying trust" definitions*). The Ruling supersedes and replaces that earlier ruling with effect from the 1997-98 income year.

Background

Some taxpayers are unsure of the relationship between the unit trust and qualifying trust definitions. This ruling provides clarification.

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
CF 3	4A
DF 7	166
HE 1	211
HH 1 (8)	226(10)
HH 3 (5)	227(6)
OB 1	211
OB 1	226(1)
OZ 1 "trust rules"	227-233

Section OB 1 defines the terms "qualifying trust" and "unit trust".

Section OB 1 also defines "employee share purchase scheme" as meaning:

> a scheme approved for the time being by the Commissioner for the purposes of section DF 7.

Section OZ 1 defines the "trust rules". Broadly, these rules apply to qualifying trusts, non-qualifying trusts, and foreign trusts, but not to unit trusts.

The definitions of "qualifying trust" and "unit trust" and a brief summary of their respective tax treatments are discussed below.

Qualifying trust

Section OB 1 defines a "qualifying trust" as:

- With the exception of a superannuation fund, a trust in respect of which in all income years, commencing with the income year during which a settlement was first made on the terms of that trust until the income year in which the distribution is made:
  - No amount of trustee income was only non-resident withholding income; or
  - Neither section BD 1 (2)(c) nor section HH 4 (3B) have applied to the trustee of the trust to exclude from gross income any amount derived outside New Zealand,

  and all of the trustee's obligations in respect of the trustee's income tax liability have been satisfied:
- Including a superannuation fund.

Section BD 1 (2)(c) excludes an amount from a taxpayer's gross income if it is a foreign-sourced amount and the taxpayer is a non-resident when it is derived. Section HH 4 (3B) excludes an amount from a New Zealand resident trustee's gross income if:

- That amount is foreign-sourced income; and
- No settlor of the trust is resident in New Zealand at any time during the income year; and
- The trust is neither:
  - a superannuation fund; nor
  - a testamentary trust or an inter vivos trust where any settlor of the trust died resident in New Zealand, whether in that income year or otherwise.

The effect of a trust being a qualifying trust is, broadly, that, under section HH 3 (5), distributions from qualifying trusts other than beneficiary income are not gross income of the beneficiaries.

Unit trust

Section OB 1 defines a "unit trust" as:

any scheme or arrangement, whether made before or after the commencement of this Act, that is made for the purpose or has the effect of providing facilities for the participation, as beneficiaries under a trust, by subscribers, purchasers, or contributors, in income and gains (whether in the nature of capital or income) arising from the money, investments, and other property that are for the time being subject to the trust; but does not include -

(a) A trust for the benefit of debenture holders; or

(b) The Common Fund of the Public Trustee or any Group Investment Fund established by the Public Trustee; or

(c) The Common Fund of the Maori Trustee; or

(d) Any Group Investment Fund established under the Trustees Companies Act 1967; or

(e) Any friendly society registered under the Friendly Societies and Credit Unions Act 1982; or

(f) Any superannuation fund; or

(g) Any employee share purchase scheme; or

(h) Any other trust of any specified kind that is declared by the Governor-General by Order in Council, not to be a unit trust for the purposes of section HE 1:

Section HE 1 treats a unit trust as a company for tax purposes. The interests of the unit holders are deemed to be shares. The unit holders are deemed to be shareholders, and the income derived by the trustee is deemed to be income derived by the unit trust.

Distributions derived by unit holders are treated as dividends, subject to section CF 3 which excludes certain items from the definition of dividends. The dividends can have imputation credits attached.

Application of the Legislation

Relationship of unit trusts and qualifying trusts

A unit trust could fall within the definition of qualifying trust. However, if an entity meets all the requirements of the definition of unit trust, it falls outside the trust rules and is treated as a unit trust for tax purposes. HH 1 (8) expressly excludes unit trusts from the application of the trust rules.

To constitute a unit trust for tax purposes, an entity must meet the following requirements in the definition of unit trust:

- The entity must be a trust. It cannot be in the form of a partnership or a joint venture (presuming it does not involve a trust), as in those entities management and control are in the hands of the member. In contrast, in a trust situation the management and control of the property settled are with the trustees.
- The trust must have subscribers, purchasers, or contributors who are beneficiaries under the trust. In contrast, a family trust is not a unit trust because beneficiaries of a family trust do not subscribe, purchase, or contribute for their entitlement to distributions from the trust.
- The trust must have more than one unit holder. The use of the plural when referring to "subscribers, purchasers, or contributors" in the definition supports this interpretation. The definition does not allow nominees for subscribers, purchasers, or contributors to be counted separately. A nominee is treated as the principal when ascertaining the number of unit holders in a unit trust. The use of nominees could in some circumstances circumvent the requirement for participation by more than one unit holder. If, for example, a subscriber and his or her nominees acquired all the units in a unit trust, there would be no real participation as, in substance, there is just one subscriber.
- Unit holders must have a facility to participate in any income or gains arising from the investments that are the subject of the trust. For example, a subscriber for units that carry a nil return would not count for the purposes of the definition.

Example

Five individuals form a trust to pool their funds and make investments. An independent trustee holds the funds. The trust deed provides that each individual is a beneficiary who is entitled to participate in the income or gains arising from the investment of those funds.

The entity is a unit trust as:

- It is formed as a trust.
- There is more than one contributor.
- Each individual has contributed in his or her own right.
- Each individual will participate in the income and gains arising from the funds that are subject to the trust.

Financial planning fees: income tax deductibility

Public Ruling - BR Pub 95/10A

***Note** (not part of ruling): Public ruling BR Pub 95/10 (see TIB Volume Seven, No.7 [January 1996] at page 1) concerned sections BB 7 and BB 8 of the Income Tax Act 1994. Section 6 of the Taxation (Core Provisions) Act 1996 repeals and replaces part B of the Income Tax Act 1994, including sections BB 7 and BB 8, with effect from the 1997-1998 income year. Public ruling BR Pub 95/10 also concerned sections CB 1 - CB 15, EE 1, EF 1, and EH 1 - 9. These sections have all been amended by the Taxation (Core Provisions) Act 1996.*

Section 91G(1) of the Tax Administration Act 1994 states that when a taxation law that is the subject of a binding ruling is repealed, the ruling ceases to apply to the extent of, and from the effective date of, that repeal. Further, section 91G(2) states that where a taxation law that is the subject of a binding ruling is amended, or repealed in part only, in a manner that alters the way in which the taxation law applies, the ruling ceases to apply to the extent of, and from the effective date of, the amendment or partial repeal. This means that public ruling BR Pub 95/10 will not apply to fees for financial planning services which are incurred in the 1997-1998 income year and subsequent income years. It will apply to such fees incurred in the 1996-1997 income year.

Public ruling BR Pub 95/10A replaces public ruling BR Pub 95/10 with effect from the 1997-1998 income year. It is intended that the cessation of public ruling BR Pub 95/10 and its replacement by public ruling BR Pub 95/10A should have no practical effect on the application of the taxation law contained in the rulings to the relevant taxpayers.

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

Taxation Law

All legislative references are to the Income Tax Act 1994 as amended by the Taxation (Core Provisions) Act 1996 unless otherwise stated.

This Ruling applies in respect of sections BD 2, CB 1 - CB 15, EE 1, EF 1, and EH 1 - EH 10 of the Income Tax Act 1994.

The Arrangement to which this Ruling applies

The Arrangement is the incurring by taxpayers of 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.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

Passive investors

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

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 BD 2 (2)(e). Fees paid for planning may also be not deductible for the further reason that they do not satisfy section BD 2 (1)(b).

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 BD 2 (2)(e).

For passive investors the deductibility of implementation fees is subject to the qualified accrual rules in sections EH 1 to EH 10.

Monitoring services

Passive investors can deduct fees paid for monitoring investments under section BD 2 (1)(b)(i), 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 gross 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 BD 2 (1)(b).

For speculative investors, the deductibility of implementation fees is subject to the qualified accrual rules in sections EH 1 to EH 10.

For business investors, the deductibility of implementation fees is subject to the qualified accrual rules in sections EH 1 to EH 10, and if 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 gross 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. These fees must be dealt with under the qualified accruals rules. The distinction between passive, speculative, and business investors for such fees 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 when 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:

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- 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 deriving non-taxable 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-taxable or exempt income.

The period for which this Ruling applies

This Ruling will apply to fees for financial planning services incurred within the 1997-98 and 1998-99 income years.

This Ruling is signed by me on the 8th day of December 1996.

Jeffrey Tyler
Assistant General Manager (Adjudication & Rulings)

Commentary on Public Ruling BR Pub 95/10A

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusion(s) reached in Public Ruling BR Pub 95/10A ("the Ruling").

The subject matter covered in the Ruling was previously dealt with in BR Pub 95/10 (in TIB Volume Seven, No. 7 (January 1996) at page 1 under the heading *Financial planning fees: income tax deductibility*). The Ruling supersedes and replaces that earlier ruling with effect from the 1997-98 income year.

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.

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.

Amounts derived in those circumstances are included in the investor's gross income under sections BD 1 (1) and CD 4 and losses incurred are deductible under section BD 2 (1)(b)(i).

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

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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 *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 taxable under section 65(2)(e) (now section CD 4) does not mean that that activity is a business.
- If 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[1]	Income Tax Act 1994[2]	Income Tax Act 1976
BD 2 (1)(b)	BB 7	104
BD 2 (2)(b)	BB 8 (c)	106(1)(k)
BD 2 (2)(e)	BB 8 (a)	106(1)(a)
CB 1 - CB 15	CB 1 - CB 15	61
CD 3	BB 4 (a)	65(2)(a)
CD 4	BB 4 (c)	65(2)(e)
CE 1 (a)-(c)	CE 1 (a)-(c)	65(2)(j)-(jb)
EE 1	EE 1	85
EF 1	EF 1	104A
EH 1 - EH 10	EH 1 - EH 10	64C - 64M

1. as amended by the Taxation (Core Provisions) Act 1996
2. prior to amendment by the Taxation (Core Provisions) Act 1996

Deductibility

Section BD 2 (1), which is the general deductibility section, states:

An amount is an allowable deduction of a taxpayer

(a) ...

(b) to the extent that it is an expenditure or loss

(i) incurred by the taxpayer in deriving the taxpayer's gross income; or

(ii) necessarily incurred by the taxpayer in the course of carrying on a business for the purpose of deriving the taxpayer's gross income ...

Prohibitions on deductibility

Section BD 2 (2) qualifies the general deductibility test in section BD 2 (1).

Section BD 2 (2)(b) prohibits a deduction when the expense relates to exempt income. It denies a deduction for expenditure or loss to the extent that it is:

incurred in deriving exempt income under Part C (Income Further Defined), D (Deductions Further Defined) or F (Apportionment and Recharacterised Transactions),

Section BD 2 (2)(e) prohibits the deduction of capital. It denies a deduction for expenditure or loss to the extent that it is:

of a capital nature, unless allowed as a deduction under Part D (Deductions Further Defined) or E (Timing of Income and Deductions),

Gross income

Under section BD 1, an amount is gross income of a taxpayer if it is included in the taxpayer's gross income under Parts C - I of the Act. The following income types are relevant to this item:

- Business profits - section CD 3.
- Personal property sales - section CD 4.
- 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 gross income, and under section EE 1 (9), the value of trading stock at the beginning of the year is allowed as a deduction to the taxpayer 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 the 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-taxable or exempt income.

The general deductibility section is section BD 2. Section BD 2 (b)(i) applies to passive investors, speculative investors, and business investors if the planning expenditure is incurred in deriving the taxpayer's gross income.

Section BD 2 (1)(b)(ii) does not apply to passive investors or speculative investors because it only applies to expenditure incurred in carrying on a business.

Section BD 2 (2) contains the prohibitions on deductibility. Section BD 2 (2)(e) prohibits the deduction of expenditure of a capital nature. "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 taxable or deductible 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.

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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 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 BD 2 (2)(e). For passive investors, fees for financial plans may also not be deductible because they fail the general deductibility test under section BD 2 (1)(b)(i). The fees may not have the requisite connection with the investor's gross income to satisfy the test for deductibility under section BD 2 (1)(b)(i). 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 gross 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 the investor's gross income may be present. However, as discussed above, the fees will not be deductible because they are capital in nature.

The link between gross 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 gross income are not deductible for any investor, even if the investor is in the business of investment or is a speculative investor. This point is discussed below under *Fees incurred in gaining non-taxable 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 BD 2 (1)(b)(i).

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 gross 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 will be included in the gross 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 her professional career she has acquired a number of investments from which she has continued to derive both income and capital growth. Investor B uses the services of a financial adviser in managing her investments. While Investor B takes an interest in the performance of her investments, she leaves the majority of the work to her financial adviser. Investor B only undertakes a minimal amount of buying and selling. Except for some superannuation entitlements, Investor B derives all her income from these investments.

Investor B is not in the business of investing. Although the investments represent the majority of her income, her 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 when 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.

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Speculative investors

Planning fees, implementation fees, and monitoring fees

Speculative investors can deduct planning fees, implementation fees, and monitoring fees under section BD 2H(1)(b)(i). 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 gross 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 will be included in the gross 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 BD 2 (1)(b)(i) or (ii).

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 gross 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 will be included in the gross income of the business investor for the income year.

Planning fees

For business investors, planning fees are deductible under section BD 2 (1)(b)(i) or (ii) as they have the necessary connection with the business investor's gross 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 BD 2 (1)(b)(ii). 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 the investor's gross 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

If 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 Three, 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.

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 is 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

If 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. When implementation fees are part of the acquisition price of the arrangement, they will be one of the amounts provided by the person to be 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, if 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.

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Fees incurred in deriving non-taxable or exempt income

Returns from investments are not taxable to the investor if the investment is taxed before the investor receives 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 taxable 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-taxable or exempt income. Section BD 2 (1)(b) only allows a deduction for expenditure incurred in deriving the investor's gross income, or for expenditure necessarily incurred by the investor in the course of carrying on a business for the purpose of deriving the investor's gross income. Also, section BD 2 (2)(b) denies a deduction for expenditure incurred in deriving exempt income. Therefore, where expenditure on financial planning fees produces non-taxable 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 gross income from her investment. Section BD 2 (2)(b) prohibits the deduction of expenditure or loss incurred in deriving 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

Dispositions where the transferor reserves a benefit or advantage in real property - income tax implications

Public Ruling - BR Pub 96/2A

***Note** (not part of ruling): Public ruling BR Pub 96/2 (see TIB Volume Seven, No.8 [February 1996] at page 10) concerned sections CE 1 (1)(e), EB 1 (1), EB 2, and OB 1 of the Income Tax Act 1994. Section 27 of the Taxation (Core Provisions) Act 1996 amends section CE 1 (1), and sections 144 and 145 of that Act repeal and replace sections EB 1 (1) and EB 2, with effect from the 1997-1998 income year.*

Section 91G(1) of the Tax Administration Act 1994 states that when a taxation law that is the subject of a binding ruling is repealed, the ruling ceases to apply to the extent of, and from the effective date of, that repeal. Further, section 91G(2) states that where a taxation law that is the subject of a binding ruling is amended, or repealed in part only, in a manner that alters the way in which the taxation law applies, the ruling ceases to apply to the extent of, and from the effective date of, the amendment or partial repeal. This means that public ruling BR Pub 96/2 will not apply to dispositions of real property which are made in the 1997-98 income year and subsequent income years. It will apply to such dispositions made in the 1996-97 income year.

Public ruling BR Pub 96/2A replaces public ruling BR Pub 96/2 with effect from the 1997-98 income year. It is intended that the cessation of public ruling BR Pub 96/2 and its replacement by public ruling BR Pub 96/2A should have no practical effect on the application of the taxation law contained in the rulings to the relevant taxpayers.

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

Taxation Law

All legislative references are to the Income Tax Act 1994 as amended by the Taxation (Core Provisions) Act 1996 unless otherwise stated.

This Ruling applies in respect of sections CE 1 (1)(e), EB 1 (1), EB 2, and OB 1 (definition of "lease" and "leasehold estate") of the Income Tax Act 1994.

The Arrangement to which this Ruling applies

The Arrangement is the disposal by a taxpayer (transferor) of real property and the receipt of the property by another taxpayer (transferee), either subject to an interest still held by the transferor or subject to an obligation to grant an interest back to the transferor.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

Section CE 1 (1)(e) includes within a person's gross income all rents, fines, premiums, or other revenues derived by a land owner from:

- Any lease, licence, or easement affecting the land; or
- The grant of a right to take profits from the land.

If a transferor grants an interest in property to himself or herself, and later grants the remainder or reversion to another person (including the trustees of a trust), the interest kept by the transferor does not constitute gross income of the transferor under section CE 1 (1)(e).

If a transferor grants a property interest to another person, subject to the transferee granting an interest back to the transferor, the transferee may derive gross income under section CE 1 (1)(e). The transferee will derive gross income if:

- The transferee is indebted to the transferor and the value of the interest granted by the transferee is deducted from that indebtedness; or
- The price the transferee pays for the property is reduced by netting off from the market value of the property the value of the obligation to grant an interest to the transferor; or
- The transferor otherwise pays the transferee for the grant.

The income of the transferor from this transaction will be equal to the reduction in indebtedness, the reduction in price, or the amount otherwise paid.

If the value of interest granted by the transferee is not paid for, or is not used to reduce the price the transferee pays or the transferee's indebtedness, the transferee does not derive gross income from the grant.

If a transferor grants a property interest to another person, and the transferee grants a freehold interest to the transferor, such as a life estate or lease for life, section CE 1 (1)(e) does not apply. A freehold interest does not come within the requirement of section CE 1 (1)(e) that there be a lease, licence, easement, or profit.

The period for which this Ruling applies

This Ruling will apply to dispositions of real property made during the 1997-98 and 1998-99 income years.

This Ruling is signed by me on the 8th day of December 1996.

Jeffrey Tyler
Assistant General Manager (Adjudication & Rulings)

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Commentary on Public Ruling BR Pub 96/2A

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 96/2A ("the Ruling").

The subject matter covered in the Ruling was previously dealt with in Public Ruling BR Pub 96/2 (in TIB Volume Seven, No.8 (February 1996) at page 10, under the heading *Dispositions where the transferor reserves a benefit or advantage in real property - income tax implications*). The Ruling supersedes that earlier ruling with effect from the 1997-98 income year.

Background

This commentary sets out the application of section CE 1 (1)(e) when a taxpayer disposes of real property and keeps or reserves interests in that property.

The gift duty implications of such transactions are the subject of public binding ruling BR Pub 96/1.

Legislation

Cross-reference table

Income Tax Act 1994	Income Tax Act 1976
CE 1	65
EB 1	75
EB 2	80
OB 1	2

Under section CE 1 (1)(e), a person's gross income includes:

All rents, fines, premiums, or other revenues (including payment for or in respect of the goodwill of any business, or the benefit of any statutory licence or privilege) derived by the owner of land from any lease, licence, or easement affecting the land, or from the grant of any right of taking the profits of the land.

Application of the Legislation

Section CE 1 (1)(e) deems a person's gross income to include all rents, fines, premiums, or other revenues derived by a land owner from:

- Any lease, licence, or easement affecting the land; or
- The grant of a right to take profits from the land.

No income tax implications if an interest is kept

If the transferor effectively keeps an interest in land prior to a disposition of the remainder to another person, section CE 1 (1)(e) does not apply. The owner of land (the transferor) has not derived a rent, fine, premium, or other revenue from a lease, licence, easement, or profit. Instead, the owner has simply kept an interest in the land. The transferee has also derived no income as he or she never owned the interest that the transferor kept.

A transferor can grant himself or herself a life interest or lease over land, before disposing of the remainder or reversion to another person. However, it is not legally possible for a transferor to grant a licence to occupy to himself or herself. A licence is not an estate or interest in land. A licence is a personal permission to enter land and use it for a particular purpose. A licence must be granted from a licensor to a licensee.

Example 1

Taxpayer A creates a life estate in a property, and then transfers the remainder interest to the trustees of his family trust. A's house is worth $175,000. The value of the life estate is $60,000. The sale price for the remainder is $175,000 less the $60,000. The sale price is outstanding as an unsecured debt owed by the trust to A.

The Commissioner will not assess A for income tax under section CE 1 (1)(e) on the $60,000 value of the life estate. Section CE 1 (1)(e) has no application when a property owner keeps some part of his or her own property.

Income tax implications when an interest is reserved

If the transferor reserves an interest by receiving a grant of an interest from the transferee, section CE 1 (1)(e) generally applies. There are three parts to section CE 1 (1)(e):

- There must be either a rent, fine, premium, or other revenue.
- The income must be derived by a land owner.
- The income must be derived from a lease, licence, easement, or profit.

When the transferee is granting an interest to a transferor, the transferee is the land owner. Accordingly, it is the transferee who is at risk of being subject to income tax.

Income that is "premiums or other revenues"

For section CE 1 (1)(e) to apply there must be income from granting an interest back to the transferor. If a grant back to the transferor is for no consideration, section CE 1 (1)(e) will not apply (there may, however, be a gift duty effect).

If:

- The transferee is indebted to the transferor and the value of the interest granted by the transferee is deducted from that indebtedness; or
- The price the transferee pays for the property is reduced by netting off from the market value of the property the value of the obligation to grant an interest to the transferor; or

- The transferor otherwise pays the transferee for the grant,

the transferee may derive gross income if the other requirements (discussed below) of section CE 1 (1)(e) are met.

The gross income derived from this transaction will be equal to the reduction in indebtedness, the reduction in price, or the amount otherwise paid.

Under section CE 1 (1)(e), the value attributed to the interest granted by the transferee to the transferor is either a rent, fine, premium, or other revenue. A payment for the grant of a licence to occupy, or a lease, is included within the term "premiums, or other revenues". The Court of Appeal in *Romanos Motels Limited v CIR* [1973] 1 NZLR 435 found that an amount paid for goodwill and a lease of a motel was included within the term "premiums, or other revenues", notwithstanding that such a sum would normally be considered a capital sum. In *Capel v CIR* (1987) 9 NZTC 6,195 the High Court found that a goodwill payment was a capital sum, yet the payment was still taxable under the then equivalent to section CE 1 (1)(e). A payment for buying a licence to occupy, or a lease, would also normally be considered a capital sum. However, *Romanos* and *Capel* are authority for the proposition that such a payment is included within the term "premiums, or other revenues".

Derivation of premiums or other revenues

The premium or other revenue is "derived" by the transferee (the land owner). When there is a grant to the transferor of the licence to occupy or lease, this results in a reduction of the debt owing by the transferee to the transferor. The reduction comes about because the licence to occupy or lease has value to the transferor and the transferee, and the amount the transferor should pay for the licence or lease is credited against the debt owing to the transferor. The reduction is an amount equal to the value of the interest granted to the owner. Although the transferee does not actually receive an amount of cash from the transferor, he or she does derive the income. Under section EB 1 (1), a person derives income, even where it has not been received, when an amount has been, for example, credited in account or otherwise dealt with in the person's interest or behalf. A reduction of indebtedness is an example of this, and so the transferee "derives" the income. Another example, is a netting off of obligations.

Income derived from lease, licence, easement, or profit

If the transferee grants the transferor a lease or a licence to occupy, and there is a sum attributable to that grant, the grant satisfies the requirement that the income is derived from any lease, licence, easement, or profit. Accordingly, the transferee is subject to income tax on an amount equal to the value of the sum attributable to the grant.

Example 2

Taxpayer B has decided to transfer her family home to a family trust. She wishes to ensure that she has a right to occupy the house for the rest of her life. She transfers the house to the trustees of the trust. A condition of the sale is that the trustees grant B a licence to occupy. The trustees comply with this condition.

The house has a market value of $200,000. A valuer and actuary value the licence to occupy at $50,000. The sale price of the house is $200,000, which is reduced by $50,000 to $150,000 to take into account the value of the licence to occupy. The $150,000 is left owing by the trustees as a debt repayable on demand.

The trust has derived gross income under section CE 1 (1)(e) for the value of the licence to occupy.

However, if the lease is a lease for life, the transferee is not subject to income tax. Section OB 1 defines "lease" as any disposition by which a leasehold estate is created. "Leasehold estate" is also defined in section OB 1: it does not include a freehold estate. As a lease for life is a freehold estate, it is not a "lease" for the purposes of section CE 1 (1)(e).

If the transferee grants a life estate to the transferor, the grant is not a lease, licence, easement, or profit. Instead, it is a grant of a freehold estate in land. Accordingly, the transferee is not subject to income tax.

Example 3

C and D decide to transfer their home to a family trust. They wish to ensure that they have a right to occupy the house for the rest of their lives. They transfer the house to the trustees of the trust. A condition of the sale is that the trustees grant C and D life estates in the property. The trustees comply with this condition.

The house has a market value of $250,000. The life estates are worth $75,000. The sale price of the house is $250,000, which C and D leave owing as a debt, repayable on demand. The debt is reduced by $75,000 upon the grant of the life estates.

The trust will not have derived gross income under section CE 1 (1)(e), because the grant of a life estate is not income derived from a lease, licence, easement, or profit.

If the lease is not a lease for life, section CE 1 (1)(e) will apply in the same way as would occur with the grant of a licence, see Example 2 above.

Spreading of income

When a taxpayer derives income under section CE 1 (1)(e), section EB 2 (1) allows the person to apportion that income between the income year in which it is derived and up to five subsequent income years.

Bad debts - writing of debts as bad for GST and income tax purposes

Public Ruling - BR Pub 96/3A

***Note** (not part of ruling): Public ruling BR Pub 96/3 (see TIB Volume Seven, No. 8 [February 1996] at page 13) concerned section DJ 1 (a)(iii) of the Income Tax Act 1994. Section 100 of the Taxation (Core Provisions) Act 1996 repeals and replaces section DJ 1 (a)(iii), with effect from the 1997-98 income year. Section 91G(1) of the Tax Administration Act 1994 states that when a taxation law that is the subject of a binding ruling is repealed, the ruling ceases to apply to the extent of, and from the effective date of, that repeal. This means that public ruling BR Pub 96/3 will not apply to income tax deductions and deductions from GST output tax which are claimed in the 1997-98 income year and subsequent income years in respect of debts written off as bad debts. It will apply to such deductions claimed in the 1996-97 income year.*

Public ruling BR Pub 96/3A replaces public ruling BR Pub 96/3 with effect from the 1997-98 income year. It is intended that the cessation of public ruling BR Pub 96/3 and its replacement by public ruling BR Pub 96/3A should have no practical effect on the application of the taxation law contained in the rulings to the relevant taxpayers.

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

Taxation Law

All legislative references to the Income Tax Act are to the Income Tax Act 1994 as amended by the Taxation (Core Provisions) Act 1996 and all references to the GST Act are to the Goods and Services Tax Act 1985.

This Ruling applies in respect of section DJ 1 (a)(iii) of the Income Tax Act and section 26(1)(c) of the GST Act.

The Arrangement to which this Ruling applies

The Arrangement is the writing off of a debt (or part of a debt) as a bad debt, and the claiming of an income tax deduction or a deduction from GST output tax for that debt (or part thereof).

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

A debt (or part of a debt) must be both bad and written off before any person can claim an income tax deduction or a deduction from GST output tax (assuming that other legislative requirements in the GST Act 1985 and the Income Tax Act are also satisfied).

Debt must be "bad"

Whether or not a debt (or part of a debt) is bad is a question to be determined objectively, rather than a question to be determined by the subjective opinion of any particular individual. The objective test that any person should ask himself or herself in deciding whether or not a debt is bad, is whether the facts would indicate to a reasonable and prudent business person that, on the balance of probabilities, it is unlikely that the debt will be paid.

If the facts indicate to a reasonable and prudent business person that, on the balance of probabilities, it is unlikely that the debt will be paid, then the debt is bad at that point in time and may then be written off. Events following the writing-off may result in additional information which could indicate that a debt

(or part of a debt) previously written off as bad is no longer bad. However, this does not mean that the debt was not bad at the time of the writing-off, and does not require any change to the income tax return or GST return in which the bad debt deduction was claimed. Of course, any recovery of any part of the debt previously claimed as a bad debt deduction must be returned in the period recovered.

At the time of deciding whether a debt is bad, a person will need to have sufficient information to enable a reasonable and prudent business person to form the view that it is unlikely that the debt will be paid. The facts that need to be gathered depend on the circumstances surrounding any particular case. While no factor is decisive in itself, factors that are likely to be relevant in most cases are:

- The length of time a debt is outstanding - the longer a debt is outstanding, the more likely it is that a reasonable and prudent business person would consider the debt to be bad.
- The efforts that a taxpayer has taken to collect a debt - the greater the extent to which a person has tried (unsuccessfully) to collect a debt, the more likely it is that a reasonable and prudent person would consider the debt to be bad.
- Other information obtained by a creditor - a creditor may have obtained particular information about a debtor, e.g. through business or personal networks, that would be a factor in leading a reasonable and prudent business person to conclude that a debt is bad. For example, a creditor may know that the debtor is in financial difficulties and has defaulted on debts owed to other creditors.

A debtor does not need to be insolvent for a debt to be bad (although this will often be the case).

A debt may still be bad even though a person is taking action to recover the debt. Recovery action may be taken for a number of reasons, even though a reasonable and prudent business person would think it unlikely that the debt will be recovered.

A person cannot make a deduction by way of a provision for doubtful debts (being an estimate of the amount of debts that will become bad in the future). Bad debts are individually identifiable debts rather than a general provision.

Debt must be "written off"

A bad debt must be written off by authorised persons in accordance with the accounting and record keeping systems maintained by a taxpayer. In all cases the records kept by a taxpayer must comply with the record keeping requirements contained in the Tax Administration Act 1994 and the GST Act.

If a taxpayer maintains a debtors ledger, the balance in the debtors ledger for the individual debtor must be reduced by the amount of the bad debt. An entry in a general ledger recognising the debt as bad does not also have to be made for the debt to be written off for income tax and GST purposes.

If a debtors ledger is not maintained, action must be taken that shows that the business accounting system treats the debt as bad. Particular examples of debts accepted by the Commissioner as having been written off are:

- If a taxpayer's only records of debts are copies of invoices issued, placing the invoice in a "bad debts" file, indicating on the invoice whether all or part of the invoiced amount is bad is sufficient.

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- If a taxpayer's only records of debts are copies of invoices and copies of statements of account issued from a duplicate account book, marking the copy of the final statement sent out "bad debt" (indicating the amount of the debt that is bad) is sufficient. Alternatively, it would also be sufficient for the taxpayer to place the relevant invoice in a "bad debts" file indicating on the invoice whether all or part of the invoiced amount is bad.

Merely claiming a deduction from output tax in a GST return does not amount to the writing-off of a bad debt.

In all cases, the taxpayer must cease to recognise the debt as an asset for accounting purposes.

There is no requirement that a debt must be written off and claimed as a bad debt deduction in the income year or GST taxable period in which the debt becomes bad. However, when a bad debt deduction is claimed, the necessary accounting entries must physically have been made, or necessary action taken as the case may be, before the end of the income year or GST taxable period in which the bad debt is claimed. Writing-off cannot be backdated.

The period for which this Ruling applies

This Ruling will apply to income tax deductions and deductions from GST output tax claimed in the 1997-98 and 1998-99 income years.

This Ruling is signed by me on the 8th day of December 1996.

Jeffrey Tyler
Assistant General Manager (Adjudication & Rulings)

Commentary on Public Ruling BR Pub 96/3A

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 96/3A ("the Ruling").

The subject matter covered in the Ruling was previously dealt with in Public Ruling BR 96/3 (in TIB Volume Seven, No.8 (February 1996) at page 13 under the heading *Bad debts - writing off debts as bad for GST and income tax purposes*). The Ruling supersedes and replaces that earlier item with effect from the 1997-98 income year.

Background

The Income Tax Act and the GST Act allow deductions for bad debts for taxpayers and/or registered persons if certain criteria are met. Criteria common to both Acts are the requirements that a debt must be both bad and written off before any deduction can be made.

The Ruling sets out the test to apply when deciding whether or not a debt is "bad" and what is a sufficient "writing-off" of a bad debt.

Legislation - Income Tax Act 1994

Cross-reference table

Income Tax Act 1994[1]	Income Tax Act 1994[2]	Income Tax Act 1976
BD 2 (b)	BB 7	104
BD 2 (2)(e)	BB 8 (a)	106 (1)(a)
CE 1 (1)(d)	CE 1 (1)(d)	65(2)(jc)
DJ 1 (a)	DJ 1 (a)	106(1)(b)
EH 1	EH 1	64C
EH 3 (3)	EH 3 (3)	64D(3)
EH 4	EH 4	64F
EH 5	EH 5	64G
EH 6	EH 6	64I
OB 1	OB 1	2
OD 7	OD 7	8

1. as amended by the Taxation (Core Provisions) Act 1996
2. prior to amendment by the Taxation (Core Provisions) Act 1996

Section BD 2 (1)(b) allows a deduction for any expenditure or loss to the extent to which it is incurred by a taxpayer in deriving the taxpayer's gross income or is necessarily incurred in carrying on a business for the purpose of deriving the taxpayer's gross income.

However, notwithstanding section BD 2 (1)(b), section DJ 1 (a) prohibits the deduction of bad debts, except

when and to the extent that a number of criteria are satisfied. Section DJ 1 (a)(iii) sets out one of these criteria, namely that the debt must be proved, to the satisfaction of the Commissioner, to have been actually written off as a bad debt by the taxpayer in the income year.

Other section DJ 1 (a) criteria (in summary form) that must also be satisfied are:

- If the debt is an amount owing in respect of a financial arrangement and the accruals rules apply to the taxpayer for the financial arrangement, the deduction must be allowed under section EH 5 (see below); and
- If the debt is not an amount owing in respect of a financial arrangement to which the accruals rules apply, the bad debt must not be a loss of capital subject to section BD 2 (2)(e); and
- If:
  - The taxpayer is a company; and
  - The debt is owed by a company ("the debtor"); and
  - The amount giving rise to the debt is taken into account in calculating a loss ("the resultant loss") incurred by the debtor or any other company funded (directly or indirectly) by the debtor; and
  - Any one or more amounts have been allowed under section IG 2 or section 191A of the Income Tax Act 1976 as a deduction to the taxpayer (or to any other company which is at any time in the income year in which the resultant loss is incurred in the same group of companies as the taxpayer), in any income year commencing on or after 1 April 1993 and preceding the income year in which the bad debt is written off, in respect of the resultant loss, -

  the loss must exceed the aggregate of the amounts so allowed as a deduction.

Section EH 5

Section EH 5 deals with amounts written off as bad debts in respect of financial arrangements. The main type of arrangement, in relation to bad debts, that is excluded from the definition of "financial arrangement" in section OB 1, is a short term trade credit. This is not a financial arrangement because it is an "excepted financial arrangement" (see paragraph (d) of the definition of "excepted financial arrangement" in section OB 1). "Short term trade credit" is defined in section OB 1 as:

> ...any debt for goods or services where payment is required by the vendor within 63 days after the supply of the goods or services:

Arrangements entered into before the introduction of the accruals rules are also excluded from the definition of "financial arrangement".

Revenue bad debts

Section EH 5 (1) permits a person to deduct an amount written off as a bad debt in respect of a financial arrangement. Section EH 5 (1) will only apply in limited circumstances to a cash basis holder. This is because section EH 5 (1) only applies when and to the extent that:

- A person derives gross income in respect of the financial arrangement under:
  - Section EH 1 - one of the methods of calculating accrual income; or
  - Section EH 3 (3) - the adjustment required in any year when a person ceases to be a cash basis holder; or
  - Section EH 4 - the base price adjustment calculated in the year a financial arrangement matures or is transferred; or
  - Section EH 6 - the post facto adjustment for financial arrangements which have the effect of defeating the intent and application of the accrual regime; and
- The amount written off is attributable to that gross income.

Capital bad debts

Section EH 5 (2) provides for the deduction of the capital or principal element of a financial arrangement in certain circumstances. Section EH 5 (2) allows a person a deduction for an amount written off as a bad debt in respect of a financial arrangement (not being an amount deductible under section EH 5 (1)) when:

- The person carries on a business which comprises holding or dealing in such financial arrangements and the person is not associated with the person owing the amount written off (see section OD 7 for test of association); or
- The financial arrangement is a trade credit and the person carries on the business of dealing in the goods or services for which the trade credit is a debt. "Trade credit" is defined in section OB 1 to mean any debt for goods and services, other than a short term trade credit.

Security payments

Under section EH 5 (3), when a person receives a security payment for a loss and a deduction is not otherwise allowable for the loss, the person is allowed a deduction for the loss up to the amount of the security payment.

Bad debts recovered

Under section CE 1 (1)(d), amounts received by a person on account of a bad debt for which a deduction has previously been allowed to the person are included as gross income of the person.

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Legislation - Goods and Services Tax Act 1985

Section 26 of the GST Act is the main provision applying to bad debts for GST purposes. Section 26 applies to registered persons who account for GST on an invoice or hybrid basis. It also applies to registered persons who account for GST on a payments basis when the relevant supply is by way of a hire purchase sale or a door to door sale.

Section 26 allows a registered person to make a deduction from output tax for that portion of the amount of tax charged in relation to a supply as the amount written off as a bad debt bears to the total consideration for the supply. To claim the deduction, the registered person must satisfy a number of criteria. Section 26(1)(c) sets out one of these criteria, namely that the registered person must have written off as a bad debt the whole or part of the consideration not paid to that person.

The other criteria (in summary form) that must also be satisfied are that the registered person must have:

- Made a taxable supply for consideration in money (from which the bad debt arose); and
- Furnished a return in relation to the taxable period during which the output tax on the supply was attributable, and properly accounted for the output tax on the supply.

A proviso is effective if goods are supplied under a hire purchase agreement to which the Hire Purchase Act 1971 applies. In this case the registered person makes a deduction from output tax of the tax fraction (being the tax fraction applicable at the time the hire purchase agreement was entered into) of that portion of the amount written off as a bad debt as the cash price bears to the total amount payable under the hire purchase agreement.

There is also a special provision for registered persons who supply contracts of insurance relating to earthquakes, wars, and fires (see section 26(1A)).

Bad debts recovered

Under section 26(2), when any amount for which a deduction from output tax has properly been made is wholly or partly recovered, output tax must be returned on that amount (to the extent of the recovery) in the taxable period in which it is wholly or partly recovered.

Application of the Legislation

Debt must be "bad"

A debt must be "bad" before it can be written off and before any deduction can be claimed for that debt. The question of whether a debt is bad is a question of fact. In evaluating the facts, the Commissioner will apply an objective test. The objective test that will be applied is whether the facts would indicate to a reasonable and prudent business person that, on the balance of probabilities, it is unlikely that the debt will be paid.

This objective test was outlined by Barber DJ in *Case N69* (1991) 13 NZTC 3,541 on page 3,548:

> Naturally, the debts in question must be "bad" to be written off as bad in terms of s. 106(1)(b). This is a question of fact. Generally, an application of that criterion will not be difficult as the debtor will be insolvent. However, the debtor does not need to be insolvent for the debt to be bad. It is only necessary that there be a bona fide assessment that the debtor is unlikely to make payment of the debt. If there is a clear understanding or arrangement that there be long term credit, and if the taxpayer believes that the terms of the credit will be met, then the debt cannot be treated as bad because it is merely a situation of deferred payment. In my view, as well as the need for the writing off to be made bona fide, the circumstances must indicate to a reasonable and prudent business person that, on the balance of probability, the debt is unlikely to be recovered. This is an objective test.
>
> The creditor taxpayer may, of course still hope for recovery and is quite entitled to institute recovery procedures. It is not necessary to have taken recovery or legal steps. ... It does not follow from the taxpayer hoping for or seeking recovery that a debt is not bad. However, usually, when a debt is assessed as bad, in terms of the type of criteria I have outlined, hopes or efforts of recovery will be futile.

The test was cited with approval by Justice Doogue in the High Court decision of *Graham v CIR, Edwards Graham Ltd & Edwards v CIR*(1995) 17 NZTC 12,107, 12,111.

A similar test to that outlined by Barber DJ was outlined by Justice Tompkins in the High Court decision of *Budget Rent A Car Ltd v CIR*(1995) 17 NZTC 12,263, 12,269:

> The term "bad debt" is not defined in the Act. It, therefore, should be given its normal commercial meaning. It is a question of fact to be determined objectively. A debt becomes a bad debt when a reasonably prudent commercial person would conclude that there is no reasonable likelihood that the debt will be paid in whole or in part by the debtor or by someone else either on behalf of the debtor or otherwise.

Taxpayer's opinion

A debt is a bad debt if a reasonable and prudent business person would think that the debt is bad. A taxpayer in business is, in all likelihood, a reasonable and prudent business person. In most instances, the taxpayer's opinion will suffice.

However, the Commissioner also recognises that taxpayers have a financial interest in claiming that a debt is bad. Writing off a debt as bad entitles a taxpayer to:

- A deduction in calculating income for income tax purposes, worth up to 33 percent of the debt:
- A GST deduction from output tax of the tax fraction of the debt.

Because of this, the Commissioner may inquire into the decision to treat a debt as bad in the course of tax audits.

Taxpayers may, therefore, wish to document and retain evidence in relation to their decisions to treat debts as bad to show that they made reasonable decisions. Documentation may include noting down the information from which the decision was made that the debt was bad, and keeping copies of any correspondence relating to the debt.

Information required

The amount of information required to decide whether a debt is bad depends on the particular circumstances of each case. If the amount involved is small, a reasonable and prudent business person is likely to make limited enquiries and take limited recovery action. Particular knowledge or information obtained by a taxpayer may also reduce the need for enquiry.

Recovery action

A creditor is likely to have taken recovery action in most cases before a deduction for a bad debt is made. It is through taking recovery action that most creditors will form an opinion as to whether a debt is bad. While recovery action is being taken, a debt can only be considered bad to the extent that a reasonable and prudent business person would consider, on the balance of probabilities, it unlikely that the debt will be paid.

In some instances, taking recovery action may carry with it the reasonable expectation of recovery of some part of the amount involved. However, this will not always be the case. The decision to take recovery action and the extent of that action will depend on the circumstances surrounding any particular case. In some cases, the creditor may take only limited recovery action because enough information is held to form a reasonable view that the debt is bad. The amount of information needed depends on the circumstances.

Conversely, the creditor may take recovery action even when a reasonable view has been formed that the debt is bad. There are a number of reasons why the creditor might take recovery action, even when it is believed that it is unlikely that the debt will be recovered. This may be the case, for example, when the creditor has a policy of pursuing debtors to a certain extent to discourage customers defaulting on debt.

Provision for doubtful debts

Persons in business who provide credit often find it prudent to make some provision for the likelihood that some of their debtors will not pay. This allowance is generally calculated by estimating a percentage on the basis of past history, and applying that percentage to the total amount of debts owed to the business at balance date.

Bad debts are individually identifiable debts that are unlikely to be recovered (in practical terms). The provision for doubtful debts is an estimate of the amount that will become bad debts in the future. The Income Tax Act and the GST Act do not allow any deduction for provisions for doubtful debts.

Debts which are partially bad

In some cases there may be no reasonable expectation that the debt will be fully recovered, but there may be a reasonable expectation of partial recovery. In this case the part that the creditor has no reasonable expectation of recovering is a bad debt.

Examples of when a debt is/is not bad

Example 1

A supplier has supplied goods on credit to Mr B. Mr B owes the supplier $2,000 for the goods. The supplier knows that Mr B has left town, and that mail addressed to him is returned marked “Gone No Address”.

In this case it is reasonable to assume that the debt will not be recovered. The money owed by Mr B is a bad debt.

Example 2

C owes $100,000 to a company. The credit controller for the company has considered the likelihood of default on every loan currently owing to the company. The credit controller has estimated the likelihood of default for C to be five percent and wants to know if the company can consider $5,000 of that loan (5% of the $100,000 owing) to be a bad debt.

Making an estimate of the likelihood of default on debts is not sufficient for a debt (or a percentage thereof) to be bad. It is not reasonable to assume that the debt is bad.

Example 3

A local dairy has supplied $10 worth of bread and cigarettes to Mrs D on credit. Mrs D used to call into the shop every other day, but has not called into the shop for eight weeks and the $10 is still owing.

Given the small amount owing, it is reasonable for the dairy to make no further enquiries. On the basis of the information that the dairy has, it can be assumed that the money is unlikely to be recovered. It is a bad debt. However, if the sum involved was larger, it may be reasonable to expect the dairy to make some further enquiry.

Example 4

A solicitor has done work for Mr O and billed him for $1,700. The solicitor is on the Board of Trustees of the school attended by Mr O’s children. Furthermore, several of the solicitor’s other clients and business associates deal with Mr O on a regular basis. The solicitor has sent out a number of reminder bills because the bill is four months overdue, but has had no response. Several of the solicitor’s friends and associates have mentioned that Mr O is in financial difficulty and has had one

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of his vehicles repossessed. The solicitor's office clerk has noted that Mr O's name has been cited in the Gazette several times over recent months in respect of Court action for unpaid debts.

It is reasonable for the solicitor to characterise Mr O's debt as a bad debt.

Example 5

A debtor of Mr F is a company in liquidation. Mr F has given the liquidator notice of a debt of $10,000 owed for goods and services supplied. Mr F is an unsecured creditor. The liquidator has held a meeting of creditors. Mr F attended the meeting and received formal notice of the outcome of the meeting. The liquidator has stated that unsecured creditors will probably receive something between 45 and 50 cents in the dollar.

It is reasonable for Mr F to assume that $5,500 of the total debt is bad. Mr F is entitled to write off that part of the debt that is bad and claim a deduction for income tax and GST purposes.

At a later date, Mr F receives a letter from the liquidator, who advises that the estimate of the likely recovery has been revised. It is now expected that unsecured creditors will be paid between 70 and 75 cents in the dollar.

This does not affect the answer given above. Also, it has no effect on Mr F's GST return or income tax return if Mr F has claimed a deduction for the bad debt. If at any stage Mr F receives payment of any part of the 55 cents in the dollar written off, Mr F must:

- Include it as gross income in the income tax return for the year in which it is received (this will give rise to an income tax liability unless there are losses to offset against it, and may give rise to a provisional tax liability, depending on the taxpayer's circumstances); and
- Account for GST on the amount recovered in the same proportion as Mr F was allowed a deduction from output tax when the bad debt was written off.

Debt must be "written off"

The Income Tax Act and the GST Act allow taxpayers and/or registered persons deductions for bad debts written off. It is not enough that a debt is bad: the bad debt must also be written off. Writing off the bad debt is important because this will fix the time at which the deduction can be made. Note that there is no requirement that a debt be written off in the year it becomes bad. As Justice Tompkins in the High Court decision of *Budget Rent A Car Ltd v CIR*(supra) on page 12,271 stated:

> A debt is not normally deductible. It does not become a deductible debt if and when it becomes a bad debt. It becomes a deductible debt, if it has been incurred in the production of assessable income, when it is written off. It is the writing off that converts the debt into a deductible debt. It follows that the crucial time is the time of the writing off, not the time the debt becomes a bad debt. It also follows that the income year referred to in s 106(1)(b) is not the year the debt became bad. In my view, the income year referred to is the year during which the bad debt was "actually written off".
>
> There is no provision in the Act that requires the bad debt to be written off in the year the debt became bad. Had that been the intention of the legislature, it would have said so ...

Barber DJ in the Taxation Review Authority discussed the requirement to write off bad debts in *Case N69* (1991) 13 NZTC 3,541. Barber DJ said on page 3,547:

> I consider it elementary that the writing off of a debt as bad requires something more than the mere recognition by the taxpayer, or one or more of its executives, that a debt is unlikely to be paid. It could be reasoned that only a decision of the taxpayer to write off a debt is needed, subject to the debt being bad. However, I consider that, in terms of sec 106(1)(b), book-keeping steps must also be taken to record that the debt has been written off. Desirably, the steps would comprise a directors' resolution, if the taxpayer is a corporate, and appropriate book-keeping entries. However, it would be adequate for a responsible officer or executive of a corporate or business to merely make the appropriate book-keeping entries if he or she has that authority. An unincorporated sole trader or small unincorporated business would not, of course, have a directorate so that book entries by the trader or his or her manager will suffice. In my view, it is not possible to write off a debt as bad without the making of authorised journal entries in the books of account of the business.

In all cases, taxpayers must be able to clearly show that a bad debt has been written off. If debtors ledgers are maintained, the writing-off will be able to be clearly shown by the appropriate book-keeping entries having been made in the debtors ledger by authorised persons. If debtors ledgers are not maintained (generally where the business operations are small and the accounting systems unsophisticated), other action must be taken that shows that the business systems treat the debt as bad.

In all cases the business records kept by the taxpayer must comply with the requirements of section 22 of the Tax Administration Act 1994 and section 75 of the GST Act.

The necessary writing-off must take place before the end of the income year or GST taxable period in which the bad debt deduction is claimed. Sometimes it may be difficult from a practical point of view to make all the necessary accounting entries before the end of the income year or GST taxable period. It is, therefore, important to review all debts before the end of an income year or GST taxable period to ensure that any bad debts can be deducted in that year or GST taxable period. Writing-off cannot be back dated. The writing-off must be in the income year or GST taxable period for which the bad debt is claimed.

Accounts kept by taxpayers

Most taxpayers in business keep double-entry accounts. If a person keeps double-entry accounting records, the bad debt must be struck out of the records on which the double-entry accounts are based. Generally, this means that the balance in the debtors ledger for the individual debtor must be reduced by the amount of the bad debt.

In cases where a taxpayer does not keep double-entry accounting records and/or does not keep a debtors ledger, the person must write the debt off according to the form of records used. This means that however the person records the debt owing, the record showing the amount owed by the bad debtor must illustrate that the creditor has no reasonable expectation of getting payment for the amount of the bad debt.

For example, if the only record of debtors is a copy invoice book, it is acceptable to write across the copy invoice "BAD DEBT", with the date and a brief note of the reason (e.g. "Bankruptcy notice in newspaper").

Keeping records for credit control or other purposes

For a variety of reasons, a creditor may keep a separate record of bad debts written off. For example, the records may be necessary if the creditor should ever have the opportunity of collecting the debt in the future, or the creditor may want to keep a record of problem customers to avoid future difficulties.

As long as these records are quite separate from the accounting base records they will not affect the write-off. If the creditor ceases to recognise the debt as an asset for accounting purposes by removing it from the accounting base records, it is written off.

More than one set of accounts

Some businesses have more than one set of accounts. For example, a company may prepare:

- Financial accounts for financial reporting purposes to satisfy the requirements of the Companies Act 1955 or 1993; and
- Management accounts as a basis for management decision-making and control.

The sets of accounts may be prepared in quite different ways. For example, there are statutory requirements set out in the Financial Reporting Act 1993 for preparing financial reports that are not required when preparing management accounts; and management accounts may be prepared on the basis of estimates for some elements in order to provide very quick reports.

When the different sets of accounts rely on the same underlying debtor records, there is no problem. As long as the creditor ceases to recognise the debt as an asset for accounting purposes by removing it from the accounting base records, it is written off. However, if the debt is still recognised as an asset in the underlying records, it is not written off.

If the different sets of accounts rely on different underlying debtor records (which is very rare), the creditor should refer to the accounts that are relied on to represent the firm's financial position. For a company, these will be the accounts that are used to satisfy the company's financial reporting obligations under the relevant Companies Act.

Examples of when a bad debt is/is not written off

General facts

The following facts apply to all the following examples:

- The taxpayer's income tax balance date is 31 March.
- The only question is whether a debt has been written off. All other criteria are satisfied.
- The debt is for goods and services supplied for money.
- The supply has been included in the taxpayer's gross income for income tax purposes.

In the examples where the taxpayer is a GST registered person, the following additional facts apply:

- GST returns are filed on a two-monthly invoice basis.
- The supply has been included in a GST return.

Example 1

The taxpayer maintains a debtors ledger and is not registered for GST. The debtors ledger is written up on 31 March 1996. The entries written up include the journal entry writing off the bad debt.

The bad debt is deductible in the year ending 31 March 1996.

Example 2

The taxpayer maintains a debtors ledger and is not registered for GST. The debtors ledger is written up on 1 April 1996. The entries written up include the journal entry writing off the bad debt.

The bad debt is deductible in the year ending 31 March 1997.

Example 3

The taxpayer does not maintain a debtors ledger and is registered for GST. There is no indication on her underlying debtor records to show the status of the debt. She has claimed a deduction from output tax for the bad debt in her GST return for the taxable period ending 31 January 1996. That return was prepared in February 1996.

The taxpayer is not entitled to the deduction from GST output tax. She is not allowed a deduction for the bad debt in the income year ending 31 March 1996. Claiming the deduction from output tax for GST purposes is not a sufficient writing-off of the bad debt.

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Example 4

The taxpayer does not maintain a debtors ledger and is not registered for GST. The taxpayer's only records of debts owing to her are copies of invoices she has issued. She has placed the invoice for the debt in question in a file marked "BAD DEBTS" in February 1996.

The taxpayer is allowed a deduction for the bad debt in the year ending 31 March 1996.

Example 5

The taxpayer maintains a debtors ledger and is not registered for GST. She wrote up the debtors ledger on 31 March 1995. The entries written up include a journal entry writing off a bad debt. The taxpayer's accountant prepares her accounts in June 1995. In the course of preparing the accounts, the accountant makes a general ledger entry recognising the bad debt as a result of the debtors ledger entry made by the taxpayer on 31 March 1995.

The bad debt is deductible in the year ending 31 March 1995. That is because the underlying accounting record of the debt was altered to recognise the bad debt on 31 March 1995.

Example 6

The taxpayer does not maintain a debtors ledger and is not registered for GST. Her only records of debts owing are copies of invoices issued. On 15 March 1995 she placed the invoice for the debt in question in a file marked "BAD DEBTS". The amount of trade creditors in the taxpayer's balance sheet as at 31 March 1996 includes the bad debt. The taxpayer's profit and loss statement for the year ending 31 March 1996 includes as income the sale that has become a bad debt. The profit and loss statement does not recognise any expense for bad or doubtful debts.

The taxpayer's income tax return for the year ending 31 March 1996 includes the profit and loss statement and a "tax reconciliation statement" showing the difference between the accounting income and the amount she believes to be income for income tax purposes. The tax reconciliation statement includes a deduction for the bad debt.

The taxpayer is not allowed a deduction for the bad debt. Although the debt has been written off in the underlying accounting records, she has not ceased to recognise the debt as an asset for accounting purposes.

Example 7

The taxpayer does not maintain a debtors ledger and is not registered for GST. His only records of debts owing are copies of invoices and statements issued. In February 1996 the taxpayer became aware that a debt was bad. He stopped sending out statements for the debt and took no other action on it. In particular, he sent out no statements on the account in February and March 1996. The taxpayer continued to send out statements on all the other debts owing, including overdue accounts. The taxpayer keeps carbon copies of the statements of account in the duplicate account book from which the statements for issue are prepared. The taxpayer has tagged the final statement sent out in respect of the debt, marking it "bad debt".

The taxpayer is allowed a deduction for the bad debt in the year ending 31 March 1996. The cessation of statements of account, recorded by their absence in the duplicate account book, and the tagging of the final statement, amount to writing off the debt in his accounting system.

Debt forgiveness in consideration of natural love and affection

Public Ruling - BR Pub 96/4A

***Note** (not part of ruling): Public ruling BR Pub 96/4 (see TIB Volume Seven, No.10 [March 1996] at page 14) concerned sections BB 9, EH 4 (6), and GD 11 of the Income Tax Act 1994. Section 6 of the Taxation (Core Provisions) Act 1996 repeals and replaces section BB 9, and section 257 of that Act repeals and replaces section GD 11, with effect from the 1997-98 income year. Section 91G(1) of the Tax Administration Act 1994 states that when a taxation law that is the subject of a binding ruling is repealed, the ruling ceases to apply to the extent of, and from the effective date of, that repeal. This means that public ruling BR Pub 96/4 will not apply to the 1997-98 income year and subsequent income years, but will apply to the 1996-97 income year.*

Public ruling BR Pub 96/4A replaces public ruling BR Pub 96/4 with effect from the 1997-98 income year. It is intended that the cessation of public ruling BR Pub 96/4 and its replacement by public ruling BR Pub 96/4A should have no practical effect on the application of the taxation law contained in the rulings to the relevant taxpayers.

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

Taxation Law

All legislative references are to the Income Tax Act 1994 as amended by the Taxation (Core Provisions) Act 1996 unless otherwise stated.

This Ruling applies in respect of sections EH 4 (6), GD 11, and BG 1.

The Arrangement to which this Ruling applies

The Arrangement is the forgiveness of an amount owing under a debt by a natural person in consideration of natural love and affection.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

Section EH 4 (6) allows relief for debtors (issuers) from income tax under the accruals rules. Section EH 4 (6) allows relief when an amount under a debt is forgiven by a natural person in consideration of natural love and affection. It does not apply when an amount is forgiven by a company.

Section EH 4 (6) can apply to:

- A debt forgiveness between near relatives, such as father and child, brother and sister, husband and wife, and de facto parents; and
- A debt forgiveness by testamentary disposition; and
- A debt forgiveness by a trust settlor or creditor to a family trust, being a fixed trust where the creditor has or would have had a relationship of natural love and affection with all of the trust beneficiaries, other than residual or default beneficiaries; and
- A debt forgiveness by a trust settlor or creditor to a family trust, being a discretionary trust where the creditor has or would have had a relationship of natural love and affection with all, or all the primary, trust objects or potential beneficiaries; and
- A partial debt forgiveness; and
- A conditional debt forgiveness (where the debt is not forgiven until the conditions are fulfilled),

provided that, in each case, the requirements of the section are satisfied.

The Commissioner considers that the section does not apply to:

- A debt forgiveness to a company (including a family company); or
- A debt forgiveness by a trustee to the trust beneficiaries; or
- A debt forgiveness that forms part of a tax avoidance arrangement in terms of a provision such as section GD 11 or section BG 1.

The period for which this Ruling applies

This Ruling will apply to amounts of debts forgiven in the 1997-98 and 1998-99 income years, and applies to taxpayers with standard, early, or late balance dates for these years.

This Ruling is signed by me on the 8th day of December 1996.

Jeffrey Tyler
Assistant General Manager (Adjudication & Rulings)

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Commentary on Public Ruling BR Pub 96/4A

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 96/4A ("the Ruling").

The subject matter covered in the Ruling was previously dealt with in Public Ruling BR Pub 96/4 (in TIB Volume Seven, No.10 (March 1996) at page 14 under the heading *Debt forgiveness in consideration of natural love and affection*). The Ruling replaces and supersedes that earlier ruling with effect from the 1997-98 income year.

Background

The relevant provisions of the accruals rules are sections EH 1 to EH 10.

Base price adjustment calculations for financial arrangements are contained in section EH 4. The base price adjustment is effectively a "wash up" calculation of all income or expenditure under a financial arrangement upon the maturity, transfer, or remission of that arrangement.

Generally, under section EH 4, any principal, interest, or other amount payable on a financial arrangement that is "remitted" is gross income to the issuer. If the debt is remitted, the issuer is the debtor.

This is illustrated by the examples below.

Example 1

Creditor lends Debtor $50,000 repayable in two years with $10,000 interest. In the second year of the loan, however, Debtor is in financial difficulties. Creditor agrees to accept $50,000 with no interest in full and final settlement of Debtor's obligations. The $10,000 interest is accordingly remitted in the second year. Debtor, however, claimed an income tax deduction for $5,000 of the interest in the first year (on an accruals basis).

Assume Creditor is not a cash basis holder.

Debtor's base price adjustment in the second year effectively results in the recapture of her income tax deduction of $5,000. She has derived gross income of $5,000. Her gross income is calculated as follows:

a + (b - c)
= $50,000 - ($50,000 + $5,000)
= - $5,000 (income).

(A negative result is income for an issuer).

For Creditor, the holder of the financial arrangement, a bad debt deduction for the $5,000 forgiven would be available if the requirements of section EH 5 (1) were satisfied prior to the remission.

Example 2

Assume that Creditor made the loan under Example 1 and that Debtor had claimed an income tax deduction of $5,000 in the first year (on an accruals basis). Assume, however, that after the first year, Debtor's financial difficulties lead the parties to agree that only $40,000 of principal and $10,000 of interest would be repaid in the second year's full and final settlement. If the balance of the interest ($5,000) were deductible by Debtor in the second year, she would have gross income of $5,000 under the base price adjustment. This is because the deductible interest in that year would partly offset her taxable remission income of $10,000. Debtor's base price adjustment would be:

a - (b + c)
= $40,000 + $10,000 - ($50,000 + $5,000)
= - $5,000 (income).

Creditor could only claim a deduction for the remission under section EH 5 (2) if she satisfied the requirements of that subsection prior to the remission. Creditor would only be entitled to a bad debt deduction if she carried on a business of holding or dealing in such financial arrangements and was not associated with Debtor.

Legislation

Cross-reference table

Income Tax Act 1994[1]	Income Tax Act 1994[2]	Income Tax Act 1976
BG 1	BB 9	99
EH 4 (6)	EH 4 (6)	64F(7B)
EH 4	EH 4	64F
EH 5	EH 5	64G
GD 11	GD 11	64J

1. as amended by the Taxation (Core Provisions) Act 1996
2. prior to amendment by the Taxation (Core Provisions) Act 1996

Section EH 4 (6) allows issuers relief from the taxation of remissions for certain intra-family and private debts. It replaces, without material amendment, the former section 64F(7B) of the Income Tax Act 1976. Section 64F(7B) applied to debt forgiveness from 1 October 1987.

Before 1 October 1987, section 64F(7A) applied to forgiveness by testamentary disposition, and section 64F(7) applied to other forgiveness. The terms and effect of those two subsections differ from sections 64F(7B) and EH 4 (6). Section EH 4 (6) applies to both testamentary and other debt forgiveness.

Section EH 4 (6)

Section EH 4 (6) states:

Where an amount owing under a debt (including any amount accrued and unpaid at the time of the forgiveness) is forgiven by a natural person in consideration of natural love and affection, the amount forgiven shall, for the purposes of the qualified accruals rules, be deemed to have been paid when the amount is forgiven.

Application of the Legislation

Requirements of section EH 4 (6)

In summary, for section EH 4 (6) to apply:

- There must be an amount owing.
- It must be owing under a debt.
- It may include any amount accrued and unpaid.
- It must be forgiven.
- It must be forgiven by a natural person.
- It must be forgiven in consideration of natural love and affection.

The following discusses some of the requirements of the subsection.

Debt

Section EH 4 (6) only applies when there is "an amount owing under a debt". It is not available for forgiveness of all types of "financial arrangement" that may be subject to the accruals rules. "Financial arrangement" as defined in section OB 1 is a very broad term. For example, it includes sell-back and buy-back arrangements, debt defeasances, and assignments of income. None of these is, in itself, a debt.

"Debt" is not defined in the Act. Accordingly, the expression is given its ordinary or common meaning. In legal terms a "debt" is understood to be a liquidated money demand or something recoverable in court by action for debt. A debt is a certain sum due from one person to another, either by record (e.g. court judgment) or in writing.

Forgiven

An amount under a debt must be "forgiven" for section EH 4 (6) to apply. The expression "forgiven" does not necessarily mean the same thing as "remitted" (as defined for accruals rules purposes in section EH 4 (9)(c)). "Remitted" includes a wider range of events that are not necessarily forgiveness. These events could include when the issuer has been released from making payments by operation of statute (e.g. the Insolvency Act 1967) or lapse of time (e.g. become statute barred).

"Forgiven" is not defined in the Act. The expression must be given its ordinary or common meaning. That is the giving up of any claim to restitution or remedy for an obligation. That forgiveness must be a positive act by the creditor (holder) as opposed to a consequence of the operation of statute or the lapse of time.

Such forgiveness is normally evidenced by a deed or other document.

Partial forgiveness

The Commissioner considers that section EH 4 (6) can apply to a partial debt forgiveness. The subsection applies in broadly the same way as to a full debt forgiveness. It deems the amount forgiven to be paid for the purposes of the base price adjustment calculation. A difference, however, is that a partial debt remission does not trigger a base price adjustment, unless it accompanies maturity or transfer of the financial arrangement.

Conditional forgiveness

If a forgiveness is conditional, it does not occur until the conditions are fulfilled. Accordingly, the Commissioner considers that the amount conditionally forgiven is not deemed paid under section EH 4 (6) until the conditions are fulfilled.

Natural person

The person forgiving the debt (the creditor or holder) must be a "natural person". The expression "natural person" is a legal term. Its meaning is not altered by the Act. It is a human being as opposed to an artificial person (such as a company): *Pharmaceutical Society v London & Provincial Supply Assn* (1880) 5 A.C. 857, 869-870.

This item sets out the Commissioner's interpretation of "natural person" for deceased persons and for trusts settled by natural persons.

In consideration of natural love and affection

This requirement of the subsection confines it to family and other private transactions. It does not apply to business or commercial arrangements.

The phrase "in consideration of natural love and affection" is another legal concept. It is not further defined in the Act.

Natural love and affection is generally considered to subsist between near relatives, such as father and child, brother and sister, and husband and wife. The Commissioner considers that natural love and affection can equally subsist within families with married or de facto married parents.

Except as discussed below in relation to trusts, the Commissioner considers that section EH 4 (6) requires that the natural love and affection exist between the creditor and the debtor.

The Commissioner considers that in some cases it would be possible for natural love and affection to be present outside the strict married or de facto married family. For example it could be present between life-long friends (although not ordinary friends or colleagues).

Inland Revenue does not propose to publish detailed rules or guidelines on the degree of relationship necessary to establish natural love and affection. This question can only be considered on a case by case basis.

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A forgiveness to a company or other non-natural person is not in consideration of natural love and affection.

Debt is deemed paid

If the requirements of section EH 4 (6) are satisfied, the amount of the debt forgiven is deemed paid. This includes any amount accrued and unpaid on the debt. This consequence is deemed for all purposes within the qualified accruals rules.

The main provisions when this deemed payment is relevant are sections EH 4 (base price adjustment) and EH 5 (bad debts). Broadly, the effect for the issuer or debtor is that no taxable remission arises on a base price adjustment. For the holder or creditor, no bad debt deduction is available under section EH 5 because the amount forgiven is deemed paid. Also, any interest or accruals income forgiven is taxable to the holder, for the same reason.

Example 3

Assume that the forgiveness is as in Example 1. Assume, however, that Creditor and Debtor are closely related (sisters) and that the requirements of section EH 4 (6) are satisfied.

Debtor has claimed a $5,000 interest deduction in the first year. In the second year, rather than $5,000 of gross income as in Example 1, Debtor's base price adjustment would result in expenditure of $5,000. This is the balance of the interest remitted that is deemed paid. Her calculation would be:

a - (b + c)
= ($50,000 + $10,000) - ($50,000 + $5,000)
= $5,000 (expenditure).

(The amount deemed paid, $10,000, is added into item 'a').

Creditor is required over the two years to return the $10,000 of interest remitted as gross income under the accruals rules. No bad debt deduction is available for the remission as it is deemed paid.

Example 4

Assume that the forgiveness is as in Example 2. Assume, however, that Creditor and Debtor are closely related (sisters) and that the requirements of section EH 4 (6) are satisfied.

Rather than $5,000 of gross income as in Example 2, Debtor's base price adjustment would result in expenditure of $5,000. This is the balance of the interest paid. The $10,000 of debt remitted is not taxable to Debtor, as Debtor is deemed to have paid it. Debtor's calculation would be:

a - (b + c)
= ($50,000 + $10,000) - ($50,000 + $5,000)
= $5,000 (expenditure).

Creditor is assessed on the $10,000 interest received. She is not entitled to a bad debt deduction for the remission as it is deemed paid.

Testamentary dispositions and trusts

Taxpayers and advisers have asked Inland Revenue to set out the Commissioner's interpretation of section EH 4 (6) for testamentary dispositions and trusts.

Testamentary dispositions

The question has arisen as to whether a deceased taxpayer can be a "natural person" for section EH 4 (6) purposes. For example, can section EH 4 (6) apply to a debt forgiveness by will when the other requirements of that provision are present?

The Commissioner considers that the deceased can be a "natural person" and that section EH 4 (6) can apply. This is because, under section 24 of the Wills Act 1837 (UK), in relation to the property of the deceased, a will speaks and takes effect from the time immediately prior to the deceased's death. (The Wills Act 1837 (UK) has been incorporated into New Zealand law).

Accordingly, the Commissioner considers that section EH 4 (6) will apply to a testamentary debt when its requirements would have been satisfied immediately prior to the deceased's death.

Family fixed trusts

The issue has also arisen of whether the forgiveness of debt to a trust may satisfy section EH 4 (6). The situation envisaged is when a trust settlor or creditor is a natural person. He or she has natural love and affection for the trust beneficiaries. The trust is a fixed trust (i.e. the trust deed sets out the share or interest that each beneficiary is to take) for beneficiaries. The trust owes the settlor or creditor a debt. The creditor forgives the debt to the trust.

The Commissioner considers that the subsection can apply, provided that all the requirements are satisfied. The Commissioner considers that it is necessary to "look through" the trust from the creditor to the beneficiaries in determining whether there is natural love and affection. The presence or absence of that state between the creditor and the trustee, in his or her private capacity, is irrelevant. Similarly, the presence or absence of that state between the trustee and the beneficiaries is irrelevant.

The state must exist, or have existed, between the natural person creditor and all of the trust's beneficiaries (subject to the comments below about certain residual or default beneficiaries).

Family discretionary trusts

The position is less clear for discretionary trusts when the class of beneficiaries includes persons for whom the settlor or other creditor has natural love or affection.

For the reasons outlined above, the Commissioner considers that the subsection can apply when either all, or all of the primary, trust objects or potential beneficiaries are persons for whom the creditor has or would have had natural love and affection.

Family trusts with certain residual or default beneficiaries

A related question is whether the subsection applies if a fixed trust has certain residual or default beneficiaries for which the settlor does not have natural love and affection. For example, it is common for family trusts to have charities and similar bodies as residual beneficiaries.

The Commissioner considers that this would not preclude the subsection from applying. The Commissioner considers that it will usually be sufficient if the creditor has, or would have had, natural love and affection for the primary beneficiaries of the trust.

Section EH 4 (6) will not apply when a charity or other person unrelated to the person forgiving is a primary beneficiary. Similarly, the subsection will not apply when family members are not the obvious focus of a discretionary trust deed. Inland Revenue does not propose to publish guidelines on the distinction between primary and minor beneficiaries. If necessary, this issue can be considered on a case by case basis.

Example 5

Son owes Father a debt of $10,000. Father dies, and his will provides for the debt to be forgiven. Section EH 4 (6) applies and Son is deemed to have paid the debt to Father for accruals purposes.

Example 6

Mother has established a trust, with her children as beneficiaries as to one-third each. The residual beneficiary, if the other beneficiaries pre-decease, is a charity for the promotion of musical education. Mother has sold her business assets to the trust for a debt back owed by the trust of $100,000. Mother forgives the $100,000 debt in consideration of natural love and affection of the beneficiaries. Section EH 4 (6) applies and the trustee is deemed to have paid the debt for accruals purposes. The existence of the residual beneficiary does not prevent the subsection applying.

Example 7

Prior to his death, the deceased established a family discretionary trust for his children. He lent the trust money to pay for an overseas trip by his children. His will provided for the loans to be forgiven. Section EH 4 (6) applies and the trustee is deemed to have paid the debt for accruals purposes.

Situations where section EH 4 (6) does not apply

The Commissioner considers that section EH 4 (6) is not applicable when:

- The party that owes the debt which is forgiven is a company. This includes a family company or close company. In the Commissioner's view, a person can never have natural love and affection for a company or other artificial person. The Commissioner has considered submissions that focus upon the similarities between family companies and family trust arrangements. However, there is a clear legal distinction between these chosen vehicles, in that a company has separate legal personality from its shareholders. Accordingly, any relationship between the creditor and the shareholders is irrelevant.
- A trustee forgives a debt owed by the trust beneficiaries. This is irrespective of a trustee's natural love and affection for the beneficiaries. The trustee's natural love and affection arises in his or her personal capacity. It would be improper for the trustee to forgive a debt in consideration of his or her natural love and affection for the beneficiaries. The trustee could only forgive in accordance with his or her duties as trustee (as set out in the trust deed). At least in the statutory context of section EH 4 (6), the Commissioner considers that a trustee acting in his or her capacity as trustee is not a natural person. The settlor's natural love and affection for the beneficiaries would also be irrelevant as the forgiveness would be by the trustee.
- The debt forgiveness forms part of a tax avoidance arrangement in terms of a provision such as section GD 11 or BG 1. For example, an individual taxpayer owes a bank an amount under a debt which she cannot pay in full. The individual pays what she can, and the bank, in turn, transfers the balance of the debt to the taxpayer's spouse for nominal consideration. The spouse forgives the balance supposedly within section EH 4 (6). In these circumstances the Commissioner might invoke an anti-avoidance provision such as section BG 1.

Bay of Plenty Co-operative Fertiliser Company Ltd's offer to Southfert Co-operative Ltd shareholders

Product Ruling - BR Prd 96/40

This is a product ruling made under section 91F of the Tax Administration Act 1994.

Taxation Laws

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

This Ruling applies in respect of section HH 3 (5), the definition of "beneficiary income" in section OB 1, section EH 1 and section EH 4.

The Arrangement to which this Ruling applies

The Arrangement is that pursuant to the offer document dated 29 August 1996 ("Offer Document") to Southfert Co-operative Limited ("Southfert") shareholders, Bay of Plenty Co-operative Fertiliser Company Limited ("BOP") offers to purchase all the ordinary shares of $1.00 each of Southfert.

Each Southfert shareholder who accepts the above offer will receive as consideration for the Southfert shares sold to BOP:

- Initially, one fully paid BOP share for every two Southfert shares sold to BOP; and
- Additional fully paid BOP shares in the 1996/97, 1997/98 and 1998/99 seasons for each tonne of fertiliser purchased by the particular Southfert shareholder ("deferred consideration"). Instead of issuing the BOP shares in progressive stages, BOP will issue BOP shares in respect of the deferred consideration immediately to the Southfert/BOP Fertiliser Trust Company Limited ("Trustee") which will hold the BOP shares on trust ("the Trust") pending release to the Southfert shareholders in successive seasons. At the end of each of the three seasons following settlement, BOP will notify the Trustee of the amount of BOP shares which should be provided as deferred consideration, and the Trustee will transfer the relevant BOP shares to those persons.

If the Trustee has insufficient shares to satisfy the payment of the deferred consideration, BOP may issue further shares to the Trustee. Alternatively, BOP may issue shares directly to the Southfert shareholders or pay an amount of cash to the Southfert shareholders equal to the value of the BOP shares constituting deferred consideration which BOP or the Trustee is obliged to provide in terms of the offer.

Terms and conditions of BOP shares issued

The BOP shares initially issued to the Southfert shareholders will be non-voting and not be entitled to receive any distributions (as defined in section 2 of the Companies Act 1993), bonus issues, cash issues or any other benefit provided to BOP shareholders prior to 31 May 1999. However, the Southfert shareholders will be entitled to receive all rebates or other distributions based on the volume of trading between the holder of the share and BOP.

The BOP shares transferred to the Trust will be non-voting and will not carry any rights to receive dividends, rebates or distributions of any nature whatsoever.

After 31 May 1999, all the BOP shares issued in respect of the Southfert shares (the BOP shares initially issued to the Southfert shareholders and the deferred consideration) will become pari passu with all other ordinary BOP shares because they will carry the same rights as all other ordinary BOP shares.

Terms and conditions of the Trust

Pursuant to the trust deed dated 29 August 1996 between BOP and the Trustee, BOP will pay the expenses of the Trustee, although the Trustee will not be remunerated.

The Trust will not provide any consideration for the transfer of shares from BOP. It will also not receive any consideration when it distributes the BOP shares to the Southfert shareholders.

The Trust will not derive any income for the time it holds the BOP shares.

The Southfert shareholders will not have any rights or interests in the BOP shares held by the Trust except as expressly set out in clause 3 of the trust deed (which relates to the tonnage of fertiliser purchased).

BOP will not have any rights to, or interests in the BOP shares held by the Trust or any other asset of any nature held by the Trust.

If there are surplus BOP shares remaining in the Trust after the deferred consideration obligations have been discharged, those shares will be cancelled or extinguished for nil consideration to the Trustee.

Other facts of the Arrangement and relevant information are as set out in the:

- Offer Document dated 29 August 1996; and
- Trust deed dated 29 August 1996 between BOP and the Trustee; and
- Application for this product ruling dated 12 August 1996.

Assumptions made by the Commissioner

This Ruling is made on the assumptions that:

- The transactions between BOP and the Southfert shareholders are at arm's length; and
- BOP will provide a service for the benefit of the Trust at less than market value being the payment of the administration fees of the Trust; and
- BOP is a resident for New Zealand tax purposes; and
- The lowest price that BOP and the Southfert shareholders who accept BOP's offer would have agreed upon for the Southfert shares being sold, at the time that the agreement for sale and purchase of the Southfert shares is entered into on the basis of full payment to the Southfert shareholders at the time at which the Southfert shares are transferred to BOP, is equal to the value of all BOP shares which are required to be provided to those Southfert shareholders pursuant to the terms of the offer (the BOP shares initially issued to the Southfert shareholders and the deferred consideration).

How the Taxation Laws apply to the Arrangement

Subject in all respects to the assumptions above, the Taxation Laws apply to the Arrangement as follows:

- The distributions of BOP shares from the Trust to the Southfert shareholders (in their capacity as beneficiaries) will not be assessable for income tax pursuant to section HH 3 (5) and the definition of "beneficiary income" in section OB 1; and
- The price of the Southfert shares is the value of the BOP shares which are required to be provided by BOP under the terms of the offer (the BOP shares initially issued to the Southfert shareholders and the deferred consideration); and
- No accrual expenditure or income under section EH 1 or EH 4 will arise to the Southfert shareholders from the "financial arrangement" (as defined in section OB 1) that is created by the Arrangement.

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The period for which this Ruling applies

This Ruling will apply for the period from 5 December 1996 to 31 March 2001.

This Ruling is signed by me on the 4th day of December 1996.

Martin Smith
General Manager (Adjudication and Rulings)

Public rulings issued as at 8 December 1996

To date, under section 91D of the Tax Administration Act 1994 the Commissioner has issued the public rulings listed below. The rulings appeared in the TIBs as shown.

BR Pub No.	Title	TIB reference
95/1	Associated non-profit bodies - $1,000 income tax exemption	P.4, TIB 7.2
95/1A	Associated non-profit bodies - $1,000 income tax exemption*	P.13, TIB 8.10
95/2	GST: sale of long-term residential properties	P.5, TIB 7.2
95/3	GST: secondhand goods input tax deduction for forestry rights	P.1, TIB 7.3
95/4	Companies claiming an income tax deduction for gifts of money	P.3, TIB 7.3
95/5	Relationship between the “unit trust” and “qualifying trust” definitions	P.5, TIB 7.5
95/5A	Relationship between the “unit trust” and “qualifying trust” definitions*	P.15, TIB 8.10
95/6	Tax treatment of credit card companies’ frequent flyer schemes	P.7, TIB 7.5
95/7	Bonus payments - tax deductions and assessability	P.1, TIB 7.6
95/8	Tertiary student association fees	P.5, TIB 7.6
95/9	GST: importers and input tax deductions	P.15, TIB 7.7
95/10	Financial planning fees: income tax deductibility	P.1, TIB 7.7
95/10A	Financial planning fees: income tax deductibility*	P.18, TIB 8.10
95/11	GST treatment of financial planning fees	P.11, TIB 7.7
95/12	GST and supplies paid for in foreign currency	P.17, TIB 7.7
96/1	Dispositions where the transferor reserves a benefit or advantage in real property - gift duty implications	P.1, TIB 7.8
96/2	Dispositions where the transferor reserves a benefit or advantage in real property - income tax implications	P.10, TIB 7.8
96/2A	Dispositions where the transferor reserves a benefit or advantage in real property - income tax implications*	P.28, TIB 8.10
96/3	Bad debts - writing off debts as bad for GST and income tax purposes	P.13, TIB 7.8
96/3A	Bad debts - writing off debts as bad for GST and income tax purposes*	P.32, TIB 8.10
96/4	Debt forgiveness in consideration of natural love and affection	P.14, TIB 7.10
96/4A	Debt forgiveness in consideration of natural love and affection*	P.40, TIB 8.10
96/5	Licensed premises operators and entertainment	P.1, TIB 7.12
96/6	Definition of “transitional capital amount”	P.4, TIB 7.12
96/7	GST: when the supply of leasehold land is an exempt supply	P.6, TIB 7.12
96/8	Whether section CD 1 (4)(a)(i) and section CD 1 (7)(a) income tax exemptions apply to non-natural persons	P.1, TIB 7.13
96/9	Taxation of commissions received by life agents on own policies and family policies	P.5, TIB 8.8
96/9A	Taxation of commissions received by life agents on own policies and family policies*	P.6, TIB 8.8
96/10	GST: advertising space and advertising time sold to non-residents	P.13, TIB 8.8
96/11	GST: input tax deductions for finance lease financiers and the appropriate method for section 21 adjustments	P.4, TIB 8.10
96/12	GST: time of supply when payment is made by cheque, credit card, charge card or irrevocable letter of credit	P.10, TIB 8.10

** In terms of the Income Tax Act 1994 as amended by the Taxation (Core Provisions) Act 1996.*

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

Tax treatment of United Nations Joint Staff Pension Fund pensions

Section CB 9 (e): Income exempted from income tax by another Act: A taxpayer is an ex-employee of the United Nations and the recipient of a United Nations Joint Staff Pension Fund (UNJSPF) pension. She has asked whether the pension is exempt from New Zealand income tax under section CB 9 (e).

Section CB 9 (e) exempts from tax:

Income expressly exempted from income tax by any other Act, to the extent of the exemption so provided.

The Act that the taxpayer believes exempts her from tax is the Diplomatic Privileges and Immunities Act 1968. Section 9 of that Act allows the Governor General to make regulations exempting staff of international organisations, such as the United Nations, from New Zealand tax. Regulations made under the predecessor to the 1968 Act, and still in force because of section 20(d) of the Acts Interpretation Act 1924, provide for certain exemptions for staff of the United Nations (there are also regulations covering staff of other United Nations agencies such as the World Health Organisation).

However, the regulations (such as regulations 11 to 14 of the Diplomatic Privileges (United Nations) Order 1959) only exempt current employees of the United Nations from tax. They do not exempt ex-staff members from tax on pensions in respect of past service, particularly if those pensions are paid not by the United Nations but by the UNJSPF. Accordingly, the Diplomatic Privileges and Immunities Act 1968 and the Orders made under that Act (or its predecessors) do not apply to make the pensions exempt from tax.

This means it is necessary to determine if the pension is taxable in New Zealand. The pension is taxable in New Zealand and it is taxable for the following reasons. A non-resident contributory superannuation scheme, like the UNJSPF, is a unit trust as defined in the Income Tax Act 1994. As such it is deemed to be a company for tax purposes. Distributions from a unit trust are treated as dividends for tax purposes. Therefore, the pension payments are assessable distributions from a unit trust. Generally, distributions from superannuation funds are exempt from income tax to the beneficiaries. However, the UNJSPF is not a "superannuation fund" as defined in section OB 1, so the exemption cannot apply to them. The UNJSPF is not a "superannuation fund" because the fund is not registered under the Superannuation Schemes Act 1989.

Furthermore, the foreign investment fund (FIF) income tax rules apply to the UNJSPF, unless an exemption to the FIF regime applies. Exemptions that could possibly apply, depending on the precise terms of the UNJSPF's constituent documents and the circumstances of the recipient, include the employment-related foreign superannuation scheme exemption, the qualifying foreign private annuity (QFPA) exemption, or the exemption for interests of no more than

$20,000. For more detail on the FIF regime, and the exemptions, see our booklet *Foreign Investment Funds*(IR 275B). For more details on the QFPA exemption see the appendix to TIB Volume Eight, No.5 (September 1996). If an FIF regime exemption applies, it merely means that the FIF regime (including its reporting requirements) does not apply. It does not mean there is a general income tax exemption. Pensions from the UNJSPF will still be taxed as an assessable distribution from a unit trust.

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'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.

Challenging the validity of an assessment by judicial review proceedings

Case: New Zealand Wool Board v CIR

Keywords: *Validity of assessment, objection proceedings, judicial review*

Summary: The Objector was unable to challenge the validity of the Commissioner's assessment by judicial review, as an assessment had been issued, and an objection filed, which was clearly destined for the High Court. The Objector first had to exhaust the objection process in order to challenge the correctness and validity of the assessment.

Facts: The Objector invested $100 million in redeemable preference shares, and treated all dividends received as exempt income under section 63 of the Income Tax Act 1976. The Commissioner issued an amended assessment and the Objector objected challenging both the correctness of the assessment and its validity. The Objector challenged the validity of the assessment and applied for judicial review in the High Court. The Commissioner informed the court that the objection would be disallowed.

Decision: The Court held when an assessment has been made, a taxpayer challenging the validity of that assessment should use the statutory objection procedure; following *Golden Bay Cement Co Ltd* v *CIR*.

The Court held when no assessment has been made, the statutory objection procedure will not be available, and therefore, the taxpayer may seek judicial review; following *BNZ Finance Ltd* v *Holland & Nash*

The Court found in the present case that an assessment had been made, and an objection lodged, and the objection proceedings were clearly destined for the High Court where, as a matter of common sense, they would be consolidated with the judicial review proceedings. Therefore, the Court held that the Objector first had to exhaust the objection process in order to challenge the correctness and validity of the assessment.

Ability to lead evidence on the Commissioner's actions and procedures

Case: High Court Auckland M 245/96

Act: Taxation Review Authorities Act 1994 - section 24

Keywords: *Taxation Review Authorities powers, challenge to validity*

Summary: The High Court found that the Objector was entitled to lead evidence necessary to enable the TRA to deal with the matter in the manner for which the Objector

contends. The TRA does not attack the method by which the Commissioner reaches his decision, rather it reaches its own decision as to an appropriate assessment.

Facts: This case concerned an appeal to the High Court regarding the Objector's ability to cross examine and lead evidence on the Commissioner's actions and procedures.

Decision: The High Court held that the TRA has all the powers of the Commissioner (at s 32 of ITA 1976) and may receive any evidence, whether normally admissible or not. Therefore, it can make any assessment which the Commissioner is empowered to make, and can hear the taxpayer's case without examining the process which led to the Commissioner's assessment. In reaching its own decision as to the appropriate assessment to be made the TRA can cure any defects that may have existed in the Commissioner's assessment. Therefore, the High Court held that a challenge to process is effected, not by attacking the method by which the Commissioner reached his decision, but by calling the evidence necessary to enable the TRA to make a correct decision.

Amended assessments of group companies disallowing deductions for loss setoffs

Case: Hotdip Galvanisers (Christchurch Limited) v CIR

Act: Income Tax Act 1976 - sections 191(5), (7A), (7B), and 188(4)

Keywords: *Group companies, loss setoffs*

Summary: The Commissioner determined that interest deductions in respect of a loss company were remitted under section 188(4) of the Income Tax Act 1976. The Court found that the Commissioner was entitled to issue amended assessments to group companies disallowing the deduction for loss setoffs.

Facts: Three companies formed a specified group for the purposes of section 191(5). For two income years losses incurred by one of the companies were offset against profits of the other two companies. A receiver was appointed to the loss company. The receiver paid a substantial sum of money to the debenture holders, but they made no appropriation between principal and interest. The Commissioner determined that some of the loss company's interest deductions were to be treated as being either remitted or cancelled under section 188(4). The Commissioner issued an amended assessment disallowing the deduction for the loss setoffs.

Decision: The Court held that section 191(7B) provides that any deduction of a loss incurred by another company in a group in calculating income shall be deemed a deduction to which sections 188(4), (5) and (6) apply. Therefore, the Commissioner was authorised to apply s 188(4) and issue amended assessments in respect of the group companies.

The Court held that the presumption in *Clayton's* case applied so that where a debt is paid and no appropriation is made it is presumed that the sum paid is in relation to the first debit item applied. The presumption did not require there to be competing claimants of equal priority to which the money could be appropriated.

The Court held that the Commissioner had authority to alter the companies' assessments as the first debt incurred was principal, so the interest was not paid off when the company was struck off. As liability for that interest was later cancelled the deduction in respect of the loss setoffs could not be allowed.

Profits from the sale of shares

Case: Rangatira Limited v CIR

Act: Income Tax Act 1976 - section 65(2)(a)

Keywords: *Profits from the sale of shares, assessable income*

Summary: The Privy Council found that the Objector's profits from the sale of shares were not assessable under section 65(2)(a). The Court of Appeal should not have disturbed the High Court's finding of fact unless it was shown to be wrong, and in this case the decision at first instance could have gone either way.

Facts: The Objector is an unlisted public company. From early on its majority shareholders were charitable trusts. Over a period of years the Objector consistently invested on a long-term basis in shares. Shares were disposed of from time to time and profits made but the Commissioner accepted that these were of a capital nature at least until 1983. Following this date there was evidence of a new and more speculative policy with respect to the sale of shares. Over the following seven years either 41 or 51 sale transactions had occurred, depending on the calculation method used.

The Commissioner assessed the Objector on profits from the sale of shares and securities which had been acquired on or after 1 April 1983. The High Court found largely in favour of the Objector. The Commissioner appealed and the Court of Appeal found the transactions to be assessable under section 65(2)(a) with the exception of the 1986 year which was out of time for assessment.

Decision: The Privy Council held that whether a particular business consists of or includes the buying and selling of shares from profit depends entirely upon the evidence produced as to the nature of the business activity.

However, the Privy Council held that an appellant Court should not disturb a finding of fact unless it is shown to be wrong. Therefore, the Court of Appeal should not have disturbed the finding of the trial judge in this case as the decision at first instance could have gone either way.

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.

The TIB is always printed in a multiple of four 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.*

Disputing a notice of proposed adjustment (IR 210K) - Oct 1996: *If we send you a notice to tell you we're going to adjust your tax liability, you can dispute the notice. This booklet explains the process you need to follow.*

Disputing an assessment (IR 210J) - Oct 1996: *Explains the process to follow if you want to dispute our assessment of your tax liability, or some other determination.*

How to tell if you need a special tax code (IR 23G): *Information about getting a special "flat rate" of tax deducted from your income, if the regular deduction rates don't suit your particular circumstances.*

If you disagree with us (IR 210Z) - Sep 1996: *This leaflet summarises the steps involved in disputing an assessment.*

Income from a Maori Authority (IR 286A) - Feb 1996: *For people who receive income from a Maori authority. Explains which tax return the individual owners or beneficiaries fill in and how to show the income.*

Independent Family Tax Credit (FS 3) - Sep 1996: *Introducing extra help for families, applying from 1 July 1996.*

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.*

Maori Community Officer Service (IR 286) - Apr 1996: *Introduces our tax help service for the Maori community.*

Maori Community Officer Service (IR 286) - Apr 1996: *An introduction to Inland Revenue's Maori Community Officers and the services they provide.*

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) - Jul 1996: *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 1996: *People whose end-of-year tax bill is $2,500 or more 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.*

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 Loans - how to get one and how to pay one back (SL 5) - 1996: *We've published this booklet jointly with the Ministry of Education, to tell students everything they need to know about getting a loan and paying it back.*

Superannuitants and surcharge (IR 259) - Jul 1996: *A guide to the surcharge for national superannuitants who also have other income.*

Tax facts for income-tested beneficiaries (IR 40C) - Jun 1996: *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.*

Visitor's tax guide - (IR 294) - Nov 1995: *A summary of New Zealand's tax laws and an explanation of how they apply to various types of visitors to this country.*

Business and employers

ACC premium rates - Mar 1996: *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 1996.*

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

Direct selling (IR 261) - Aug 1996: *Tax information for people who distribute for direct selling organisations.*

Electronic payments to Inland Revenue (IR 87A) - May 1995: *Explains how employers and other people who make frequent payments to Inland Revenue can have these payments automatically deducted from their bank accounts.*

Employer's guide (IR 184) - 1996: *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.*

First-time employer's guide (IR 185) - April 1996: *Explains the tax obligations of being an employer. Written for people who are thinking of taking on staff for the first time.*

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) - March 1996: *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 1996: *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.*

Making payments (IR 87C) - Nov 1996: *How to fill in the various payment forms to make sure payments are processed quickly and accurately.*

PAYE deduction tables - 1997
- 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 from 1 July 1996.

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 1996: *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.*

Smart Business (IR 120) - Jul 1996: *An introductory guide to tax obligations and record keeping, for businesses and non-profit organisations.*

Surcharge deduction tables (IR 184NS) - 1997: *PAYE deduction tables for employers whose employees are having NZ Super surcharge deducted from their wages.*

Taxes and the taxi industry (IR 272) - Feb 1996: *An explanation of how income tax and GST apply to taxi owners, drivers, and owner-operators.*

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.*

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) - Jul 1996: *A guide to RWT for people and institutions which pay interest.*

Resident withholding tax on investments (IR 279) - Jun 1996: *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

Company amalgamations (IR 4AP) - Feb 1995: *Brief guidelines for companies considering amalgamation. Contains an IR 4AM amalgamation declaration form.*

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 companies that receive dividends from overseas companies. This booklet also deals with the attributed repatriation and underlying foreign tax credit rules.*

Foreign investment funds (IR 275B) - Oct 1994: *Information for taxpayers who have overseas investments, but who don't have a controlling interest in the overseas entity.*

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 - estimating your income (CS 107G) - July 1996: *Explains how to estimate your income so your Child Support liability reflects your current circumstances.*

Child Support - how to approach the Family Court (CS 51) - July 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 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

January 1997

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

(We will accept payments received on Monday 6 January 1997 as on time for 5 January 1997.)

7 Provisional tax and/or Student Loan interim repayments: first 1997 instalment due for taxpayers with September balance dates.
Second 1997 instalment due for taxpayers with May balance dates.
Third 1997 instalment due for taxpayers with January balance dates.

Annual income tax returns due to be filed for all non-IR 5 taxpayers with September balance dates.

1996 end of year payments due (income tax, Student Loans, ACC premiums) for taxpayers with February balance dates.

QCET payment due for companies with February balance dates, if election is to be effective from the 1997 year.

15 GST return and payment for period ended 30 November 1996 due.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 January 1997 due.

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

FBT return and payment for quarter ended 31 December 1996 due.

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

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

RWT on dividends deducted during December 1996 due.

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

31 GST return and payment for period ended 31 December 1996 due.

February 1997

5 Large employers: PAYE deductions and deduction schedules for period ended 31 January 1997 due.

7 Provisional tax and/or Student Loan interim repayments: first 1998 instalment due for taxpayers with October balance dates.
Second 1997 instalment due for taxpayers with June balance dates.
Third 1997 instalment due for taxpayers with February balance dates.

1996 end of year payments due (income tax, Student Loans, ACC premiums) for taxpayers with balance dates in period March-September.

QCET payment due for companies with balance dates in period March-September, if election is to be effective from the 1997 year.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 February 1997 due.

Small employers: PAYE deductions and deduction schedules for period ended 31 January 1997 due.

Gaming machine duty return and payment for month ended 31 January 1997 due.

RWT on interest deducted during January 1997 due for monthly payers.

RWT on dividends deducted during January 1997 due.

Non-resident withholding tax (or approved issuer levy) deducted during January 1997 due.

28 GST return and payment for period ended 31 January 1997 due.

Public binding rulings and interpretation statements: your chance to comment before we finalise them

This page shows the draft public binding rulings and interpretation statements (formerly policy statements) that we now have available for your review. To give us your comments on any of these drafts, please tick the appropriate boxes, fill in your name and address, and return this page to us at the address below. We will send you a copy of the draft.

We must receive your comments by the "Comment deadline" shown if we are to take them into account in the finalised item. Please send them ***in writing, to the address below***; as we don't have the facilities to deal with your comments over the phone or at our local offices.

Name ____________________

Address ____________________

✔ *Issues papers*	*Comment Deadline*
☐ **3533**: Implications of the *Mitsubishi* decision	28/02/97

✔ *Public binding rulings*	*Comment Deadline*
☐ **2577**: GST - subdividers' payments of financial and reserve contributions to local authorities	31/01/97

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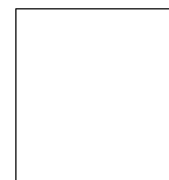

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