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TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

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YOUR OPPORTUNITY TO COMMENT

Inland Revenue regularly produces a number of statements and rulings aimed at explaining how taxation law affects taxpayers and their agents. Because we are keen to produce items that accurately and fairly reflect taxation legislation and are useful in practical situations, your input into the process, as a user of that legislation, is highly valued.

You can find a list of the items we are currently inviting submissions on as well as a list of expired items at **www.taxtechnical.ird.govt.nz** (search keywords: public consultation).

Email your submissions to us at **public.consultation@ird.govt.nz** or post them to:

Public Consultation
Tax Counsel Office
Inland Revenue PO Box 2198
Wellington 6140

You can also subscribe at **www.taxtechnical.ird.govt.nz/subscribe** to receive regular email updates when we publish new draft items for comment.

Ref	Draft type	Title	Comment deadline
ED0229	Depreciation determination	Tax Depreciation Rates for brake test rollers	20 May 2021
PUB00383	Question we've been asked	GST – How do the compulsory zero-rating of land rules apply to transactions involving commercial leases?	25 May 2021
PUB00393	Interpretation statement	Income tax and GST – deductions for businesses disrupted by the COVID-19 pandemic	28 May 2021
PUB00365	Interpretation statement	Content creators – tax issues	1 June 2021

IN SUMMARY

New legislation

Order in Council: Tax Administration (Direct Credit of Totalisator Duty, Lottery Duty, Casino Duty and Unclaimed Money) Order 2021 2

The order which came into force on 22 March 2021, specifies 27 April 2021 as the date on and from which totalisator duty, lottery duty, casino duty, and unclaimed money may be refunded by direct credit under section 184A of the Tax Administration Act 1994 to a bank account nominated by the taxpayer.

Determinations

DEP106: Tax Depreciation Rates for e-scooters and e-bicycles used in the ordinary course of business, and e-scooters, e-bicycles and bicycles (pedal) used for short term hire of 1 month or less 3

This determination sets depreciation rates for e-scooters and e-bicycles used in the ordinary course of business and for short-term hire and pedal bicycles used for short-term hire.

Participating jurisdictions for the CRS applied standard 5

New Zealand's list of participating jurisdictions for the purposes of the Common Reporting Standard (CRS rules) and requirements under Part 11B of the Tax Administration Act 1994 has been amended with effect from 1 April 2021.

Commissioner's statement

CS 21/02: Government Service Rule 6

This statement clarifies the interpretation of the Government Service Rule as set out in the Interpretation Statement on Tax Residence – IS 16/03, and sets out the Commissioner's position in relation to whether a person is "absent" for the purposes of section YD 1(7) of the Income Tax Act 2007.

Interpretation statement

IS 21/02: Income tax – Calculating income from personal services to be attributed to the working person 8

This interpretation statement provides guidance on how to calculate the amount of income from personal services that is attributed to the working person under the attribution rule in the Income Tax Act 2007. The attribution rule may apply if an entity earns income from supplying services that are personally performed by an associated person (the working person). The rule is aimed at ensuring the appropriate amount of income is recognised as being the working person's income – so taxpayers in this situation can't use associated entities to achieve a tax advantage.

Standard practice statement

SPS 21/01: Deduction notices 36

This standard practice statement sets out Inland Revenue's power to issue a deduction notice to recover outstanding amounts of tax from a third-party and provides guidance on how the Commissioner will use such notices.

Revenue alert

RA 21/01: Diverting personal services income by structuring revenue earning activities through a related entity such as a trading trust or a company: the circumstances when Inland Revenue will consider this arrangement is tax avoidance 41

Inland Revenue has always been concerned about arrangements involving taxpayers who arrange to effectively divert to a related entity some or all of the income they earn (or could earn) from a business or activity of supplying personal services - where it has the effect of taking advantage of lower marginal income tax rates payable by that entity and/or by family members as beneficiaries or shareholders of that entity. This Revenue Alert has been re-issued ahead of the increase in the top marginal tax rate on 1 April 2021 and reiterates the Commissioner's view on this matter which follows the Supreme Court's decision in *Penny and Hooper v CIR* [2011] NZSC 95.

NEW LEGISLATION

This section of the *TIB* covers new legislation, changes to legislation including general and remedial amendments, and Orders in Council.

Order in Council: Tax Administration (Direct Credit of Totalisator duty, lottery duty, casino duty, and unclaimed money) Order 2021

Sections 184A and 184B of the Tax Administration Act 1994

An Order in Council has been made to include refunds of totalisator duty, lottery duty, casino duty, and unclaimed money as tax types refundable by direct credit under section 184A of the Tax Administration Act 1994.

The provisions in sections 184A and 184B require tax refunds to be paid by direct credit to a bank account nominated by the taxpayer. Banks are phasing out the use of cheques. Tax Administration (Direct Credit of Totalisator Duty, Lottery Duty, Casino Duty, and Unclaimed Money) Order 2021 mandates the direct credit of refunds of totalisator duty, lottery duty, casino duty, and unclaimed money. Section 184A still allows the Commissioner to provide an exemption when direct crediting would cause undue hardship or is impracticable.

Background

Compulsory direct crediting for income tax and gaming machine duty was implemented when their administration was moved to Inland Revenue's new technology platform (START), which modernises and improves information flows, and enables more online self-service and automated processes. The intention is for all refunds for tax types administered by Inland Revenue to be refunded by direct credit, implementing this is occurring progressively by legislating Orders in Councils as the various tax types and associated refunds have been shifted to the new technology platform.

Application date

The Order in Council comes into effect on 27 April 2021.

LEGISLATION AND DETERMINATIONS

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

DEP106: Tax Depreciation Rates for e-scooters and e-bicycles used in the ordinary course of business, and e-scooters, e-bicycles and bicycles (pedal) used for short term hire of 1 month or less

Note to Determination DEP106:

The Commissioner has been asked to consider what depreciation rate should apply for e-scooters and e-bicycles that are used in the ordinary course of business or are available for short-term hire. In setting an economic rate for these items the Commissioner also identified that it would be appropriate to set an economic rate of depreciation for pedal bicycles that are let for short-term hire, to reflect the greater wear and tear experienced by hire industry operators.

Currently *bicycles* or *bicycles (pedal)* are only recognised when they are used in the ordinary course of business. For this reason they are included in the "Leisure" and "Transportation" industry categories. It is the Commissioner's view that the increased number of bicycles available for short-term hire also needs to be recognised and an appropriate rate of depreciation set.

"E-scooters" and "E-bicycles" will be added to both the "Leisure" and "Transportation" industry categories. They have been added to the "Hire equipment (short term hire of 1 month or less only)" asset category. The asset class of "Bicycles (pedal)" is also added to the "Hire equipment (short-term hire of 1 month or less only)" asset category.

Safety equipment supplied with hire equipment (safety helmets, for instance) are viewed as separate asset items from the scooters and bikes. Given that (individually) they are likely to cost less than the current low value asset threshold of $1000, they are treated as "low value assets" and their full cost may be claimed in the year that they are acquired and are available for use in the business[1]. However, when equipment is purchased in bulk from a supplier, at a cost greater than the threshold for low value assets, the bulk purchased assets are treated as a pooled asset and depreciated accordingly, as if they were a single asset.

When assets are damaged beyond repair or stolen, a deduction is available for the remaining book value of that damaged or stolen asset, in the income year in which the loss occurred.

[1] This same treatment applies to any low value asset; a low value bike or scooter for instance.

Determination DEP106: Tax Depreciation Rates General Determination Number 106

This determination may be cited as "Determination DEP106 Tax Depreciation Rates General Determination Number DEP106: E-scooters and e-bicycles available for use in the ordinary course of business; e-scooters, e-bicycles and bicycles (pedal) available for short-term hire".

1 Application

This determination applies to taxpayers who own items of depreciable property of the kind listed in the tables below:

This determination applies for the 2020/21 and subsequent income years.

2 Determination

Pursuant to section 91AAF of the Tax Administration Act 1994, the general determination will apply to the kind of items of depreciable property listed in the table below by:

- Adding into the "Leisure" industry category and "Transportation" asset category, the new asset classes, estimated useful lives, and general diminishing value and straight-line depreciation rates listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
E-scooter	4	50	40
E-bicycles	5	40	30
Safety equipment (other)	4	40	30

- Adding to the "Hire equipment (short term hire of 1 month or less only)" asset category, the new asset classes, estimated useful life, and general diminishing value and straight-line depreciation rates listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
E-scooters (let for hire)	3	67	67
E-bicycles (let for hire)	4	50	40
Bicycles (let for hire)	4	50	40
Safety equipment (other)	3	67	67

3 Interpretation

In this determination, unless the context otherwise requires, words and terms have the same meaning as in the Income Tax Act 2007 and the Tax Administration Act 1994.

Dated at Wellington on the 26 March 2021

Rob Falk
National Advisor
Technical Standards, Legal Services

LEGISLATION AND DETERMINATIONS

Participating jurisdictions for the CRS applied standard

Determination

New Zealand's list of participating jurisdictions for the purposes of the Common Reporting Standard (CRS rules) and requirements under Part 11B of the Tax Administration Act 1994 has been amended with effect from 1 April 2021 as follows:

Jurisdictions to be added

Albania	New Caledonia	Nigeria	Peru	Turkey

Full list of participating jurisdictions from 1 April 2021

Additions are highlighted in bold italics

Albania	Anguilla	Antigua and Barbuda	Argentina
Aruba	Australia	Austria	Azerbaijan
Bahamas	Bahrain	Barbados	Belgium
Belize	Bermuda	Brazil	British Virgin Islands
Brunei Darussalam	Bulgaria	Canada	Cayman Islands
Chile	China	Colombia	Cook Islands
Costa Rica	Croatia	Curacao	Cyprus
Czech Republic	Denmark	Dominica	Estonia
Faroe Islands	Finland	France	Germany
Ghana	Gibraltar	Greece	Greenland
Grenada	Guernsey	Hong Kong	Hungary
Iceland	India	Indonesia	Ireland
Isle of Man	Israel	Italy	Japan
Jersey	Korea	Kuwait	Latvia
Lebanon	Liechtenstein	Lithuania	Luxembourg
Macao	Malaysia	Malta	Mauritius
Mexico	Monaco	Montserrat	Nauru
Netherlands	***New Caledonia***	New Zealand	***Nigeria***
Norway	Pakistan	Panama	***Peru***
Poland	Portugal	Qatar	Romania
Russia	Saint Kitts and Nevis	Saint Lucia	Saint Vincent and the Grenadines
Samoa	San Marino	Saudi Arabia	Seychelles
Singapore	Slovak Republic	Slovenia	South Africa
Spain	Sweden	Switzerland	***Turkey***
Turks and Caicos Islands	United Arab Emirates	United Kingdom	Uruguay
Vanuatu			

For more information please refer to the Inland Revenue website: **taxtechnical.ird.govt.nz/-/media/project/ir/tt/pdfs/determinations/crs-common-reporting-standard/ae-21-01-participating-jurisdictions-for-the-crs-applied-standard**

COMMISSIONER'S STATEMENT

The purpose of a Commissioner's Statement is to inform taxpayers of the Commissioner's position and the operational approach being adopted on a particular matter. A Commissioner's Statement is not a consultative document.

CS 21/02: Government Service Rule

This Statement clarifies the interpretation of the Government Service Rule as set out in the Interpretation Statement on Tax Residence – IS 16/03, and sets out the Commissioner's position in relation to whether a person is "absent" for the purposes of section YD 1(7) of the Income Tax Act 2007.

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

Summary

1. This Statement clarifies the Commissioner's position in relation to the Government Service Rule and how it applies to Government employees.
2. A New Zealand tax resident who leaves New Zealand to be in the service of the New Zealand Government overseas, remains a New Zealand tax resident for so long as they are in the service of the New Zealand Government. The usual 325-day rule in s YD 1(5) which stops a person from being a New Zealand tax resident once they have been away from New Zealand for more than 325 days in total in a 12-month period does not apply to Government employees.
3. For the Government Service Rule to apply a person must be a New Zealand tax resident and their primary reason for leaving New Zealand must be to take up a Government position overseas. They do not need to have been in the service of the New Zealand Government before they accepted a position overseas, and it is also irrelevant whether the person is taking on a completely new role with new terms and conditions.

Background

4. The Interpretation Statement IS 16/03 on Tax residence has been reviewed with regards to the part relating to the Government Service Rule (see paragraphs [184][205]).
5. In particular, the issue reviewed was whether a person who is **not** in the service of the New Zealand Government before their departure from New Zealand, but who is a New Zealand tax resident (as defined under s YD 1) and who leaves New Zealand to take up a position with a New Zealand Government office outside New Zealand, is considered to be "absent from New Zealand in the service of the New Zealand Government" under s YD 1(7).
6. Part of IS 16/03 concluded that a person can only be absent for the purposes of s YD 1(7) if they are **already** in the service of the New Zealand Government before taking up a position overseas in the service of the New Zealand Government.
7. The Commissioner has reviewed this position and now confirms that a person leaving New Zealand to take up a position in the service of the New Zealand Government overseas, does **not** need to have been in the service of the New Zealand Government before taking up that position for the Government service rule to apply.

Explanation

8. The purpose of s YD 1(7) is for New Zealand to retain the taxing rights to the income of people absent from New Zealand but who remain closely connected to New Zealand because they are representatives and servants of the New Zealand Government overseas.
9. Section YD 1(7) of the Act provides:

> Despite subsection (5), a natural person who is personally absent from New Zealand in the service, in any capacity, of the New Zealand Government is treated as a New Zealand resident during the absence.

10. The key requirements for section YD 1(7) to apply were discussed in IS 16/03 as follows:
    - The person must be a New Zealand tax resident (as defined in YD 1);
    - The person must be present in New Zealand prior to their departure;
    - The person's primary purpose for departing New Zealand is to take up a role with the New Zealand government overseas.

11. This Statement now clarifies that a person does **not** need to be in the service of the New Zealand Government before their departure from New Zealand or, if the person is already a Government employee in New Zealand, does not need to be continuing in the same role or position they are currently working in for the Government, before their departure, to meet the above requirements.

Example

Tom has lived and worked in Queenstown for the past four years. Keen for a new challenge he applies for a new job working for a New Zealand Government agency in Tokyo. Tom is successful and he leaves New Zealand to take up his new role in Tokyo. Tom will be absent from New Zealand in the service of the Government. The primary reason for his absence from New Zealand is to carry out his duties for the Government. Tom will continue to be treated as a New Zealand resident under s YD 1(7) for as long as he is absent from New Zealand in the service of the New Zealand Government. When Tom's Government service ends, the Government Service Rule ceases to apply, and the ordinary tax residence rules will then apply.

12. This Statement also clarifies the position for a New Zealand resident (as defined under s YD 1) who is living overseas (other than for the reason of being in the service of the New Zealand Government) and who accepts a role working for the New Zealand Government overseas.
13. The Government Service Rule does not apply to such a person because their main reason for leaving New Zealand was not to take up a role in the New Zealand Government.
14. Such a person is considered to be a "locally recruited" employee, employed by the New Zealand Government. Please note, the term "locally recruited" is used here to describe the circumstances of the employees as stated in paragraph [12]. The term "locally recruited" can sometimes have a different meaning in other contexts. For example, when it is used to describe a New Zealand resident who is posted overseas from the place where they usually work ie, from their "local" office, or who is recruited through a process run by the "local" office. The terminology used does not change the tax consequences; it is the actual arrangements of the particular person that are looked at rather than what they are called.

Example

Theresa, a New Zealand expatriate, has been living and working in London for five years. Theresa is non-resident for New Zealand tax purposes – she has no permanent place of abode in New Zealand. She hears that a New Zealand Government department is looking for a person to work in its London office. She applies for the position and is successful. Theresa does not regain her New Zealand tax residency merely because she starts working for the New Zealand Government in London. Theresa did not leave New Zealand to carry out her duties for the New Zealand Government. She has been living away from New Zealand prior to being recruited for the position; this was not the reason for her absence from New Zealand.

15. There could be situations where a person is already working overseas for the New Zealand Government and the Government Service Rule applies to them, who either takes leave without pay or goes on secondment for the New Zealand Government.
16. The Government Service Rule will apply to the situations mentioned in paragraph [15] because:
    - The person was a tax resident in New Zealand before their departure; and
    - The person left New Zealand for the primary purpose of taking up a role in the New Zealand Government overseas; and
    - The person has not severed their close connection to New Zealand as they are still servants and representatives of the New Zealand Government.
17. This would also apply to persons who are in New Zealand and take up a secondment with the New Zealand Government overseas. The Government Service Rule will apply if they meet the requirements as outlined in this Statement.

Application

18. This Statement applies from the date of issue. The Commissioner will not be applying resources to examine positions taken prior to that date. If you have any concerns about compliance with the tax obligations discussed in this Statement, you should discuss the matter with a tax professional or Inland Revenue.

Rob Falk
National Advisor, Technical Standards

Date of Issue: 1 April 2021

COMMISSIONER'S STATEMENT

INTERPRETATION STATEMENT

This section of the *TIB* contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

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

IS 21/02: Income tax – Calculating income from personal services to be attributed to the working person

Summary

1. This Interpretation Statement provides guidance on how to calculate the amount of income from personal services that is attributed to the working person under the attribution rule in ss GB 27 to GB 29. The key points discussed in the Interpretation Statement are summarised as follows:

- The attribution rule may apply if an entity earns income from supplying services that are personally performed by an associated person (the working person). The attribution rule is aimed at ensuring the appropriate amount of income is recognised as being the working person's income. This prevents taxpayers from using associated entities to avoid the highest personal income tax rate on income from the supply of services that they personally perform. Income attributed under the rule is also taken into account for child support, student loan and Working for Families purposes.
- The general rule is that the amount of the entity's income that has to be attributed to the working person is **the lowest of the following three amounts** (set out in paragraphs (a) to (c) of s GB 29(1)):
  - (a) The entity's net income for the tax year, calculated as if its only income were derived from personal services

    [This will be the relevant paragraph unless either (b) or (c) apply];
  - (b) The entity's net income for the corresponding tax year

    [This paragraph will be relevant if the entity has another business or activity that was loss-making in the tax year]; or
  - (c) The entity's net income for the tax year less any losses carried forward from an earlier year from supplying personal services.
- The rules for calculating net income under **paragraph (a)** are as follows:
  - If the only income the entity derives is from supplying the services that are performed by the working person, the net income amount is simply the entity's net income for the year.
  - However, if the entity carries on another income-earning activity as well, the net income calculation excludes costs and gross income that solely relate to the non-personal services income.
- The rules for calculating net income under **paragraph (b)** are as follows:
  - The net income amount is simply the entity's net income for the tax year. All allowable deductions that are allocated to the income year come into the entity's net income.
  - Not all loss-making activities will be taken into account in the calculation. This is because not all loss-making activities affect net income. There are deduction allocation rules that apply in some situations to limit the deductions that are allocated to an income year if a particular activity is loss-making. Examples of this are the residential property ring-fencing rules, the bright-line expenditure quarantine rules, and the mixed-use asset expenditure quarantine rules.
  - In addition, tax losses carried forward from an earlier income year are not taken into account under paragraph (b). Only current year loss-making activities will come into the calculation. This is because available tax losses from earlier years do not reduce net income; rather, they are deducted from net income in calculating the person's taxable income. If the entity has losses carried forward from an earlier year, these can potentially be taken into account under paragraph (c).

- The rules for calculating net income under **paragraph (c)** are as follows:
  - The net income amount is the entity's net income for the tax year (as discussed for paragraph (b)) **less** any carried forward losses the entity has *if the loss is from a business or trading activity of supplying personal services.*
- In addition to the general calculation rules in paragraphs (a), (b) and (c), referred to above, there are various things that are specifically either taken into account or not taken into account in the income attribution calculations. The things **not taken into account** are:
  - the deduction the entity can claim for the amount of income attributed to the working person;
  - distributions of beneficiary income, if the entity is a trust; and
  - look-through status, if the entity is a look-through company (LTC) or a partnership.

    Note: The tax transparency of LTCs and partnerships is only overridden for the purposes of calculating the attribution income. LTCs and partnerships are still transparent for other tax purposes.
- The things **taken into account** are:
  - the salary the entity paid to the working person, and the taxable value of any fringe benefits the entity provided the person;
  - distributions from the entity to the working person; and
  - the market value of any unpaid administrative services provided by another person to the entity, if the entity is a partnership.
- If the personal services are performed by more than one person associated with the entity, the amount to be attributed needs to be split between the working persons. This needs to be done based on the respective value of the services performed by each working person. There are no specific rules for how to work out the respective value of the services. The most appropriate method will depend on the particular circumstances. The Commissioner will accept any reasonable basis.
- Where the entity is a company, it will at some stage pay a dividend to distribute the cash that has been attributed as income to the working person. If certain requirements are met, the company can choose the following tax treatment for these dividends (which ensures the attributable income is not subject to double taxation):
  - If the dividend is paid during the income year in which the attributable income was derived, or within six months of the end of that year, the dividend is taxable in the hands of the shareholder, but deductible to the company when calculating its net income for the purposes of the attribution rule.
  - If the dividend is paid later than six months after the end of the income year in which the attributable income was derived, the dividend is tax free in the hands of the shareholder, provided it is paid from income that has previously been attributed to the working person.
- The attribution rule may apply in relation to income from services performed overseas. In that situation, the working person may be able to claim a foreign tax credit (FTC) for tax paid by the associated entity on foreign sourced income that is attributed to the working person. If they can, the entity cannot claim an FTC for that amount. The requirements for the working person being able to claim the FTC instead of the entity are that:
  - the entity is tax resident in New Zealand;
  - the entity derived assessable income sourced outside New Zealand;
  - the amount of foreign sourced income is attributed to the working person; and
  - the working person was tax resident in New Zealand when the entity derived the attributed amount.
- There is a specific rule that applies where the entity is a trustee of a trust, and the amount attributable would cause the entity to have a tax loss for the year. In this situation, beneficiary income from the trust for the year must be reduced. There are specific rules on how this is to be done.
- The attribution rule works alongside the excess remuneration rules in ss GB 23 to GB 25B. If the remuneration subject to the excess remuneration rules is paid by a company, the way the two sets of rules work together is that the excess amount is taxed twice – both as a dividend in the hands of the person who was paid the excess remuneration, and as income to the person it is attributed to under the attribution rule. This is aimed at ensuring the correct levels of remuneration are paid and that taxpayers cannot structure their affairs in this way to split income and avoid higher personal tax rates (and gain the other advantages that may flow from splitting the income).

Introduction

2. This Interpretation Statement provides guidance on how to calculate the amount of income from personal services that is attributed to the working person under the attribution rule in ss GB 27 to GB 29.
3. The attribution rule may apply if an entity earns income from supplying services that are personally performed by an associated person (the working person). The attribution rule ensures that taxpayers cannot benefit from diverting income from personal services to an associated entity such as a company, trust, partnership or LTC. The rule prevents taxpayers from using such entities to avoid the highest personal income tax rate. It also prevents taxpayers from inappropriately reducing their child support or student loan repayment obligations, or reducing the income that is taken into account in determining Working for Families entitlements.
4. IS 19/02 *Income tax – attribution rule for income from personal services* explains in detail **when** the attribution rule will apply. There is a brief summary of when the rule will apply at [6].
5. This Interpretation Statement will be relevant if you have established that the attribution rule does apply. This Interpretation Statement:
   - provides guidance on how the attribution rule applies – that is, **how** to calculate the amount of income to be attributed to the working person in different circumstances; and
   - answers common questions about the implications of the attribution rule applying.

Overview of when the attribution rules apply

6. IS 19/02 explains in detail when the attribution rule will apply. But in summary, the rule will apply where:
   - a person (the working person) provides personal services;
   - the working person is associated with an entity (the associated entity);
   - the associated entity is inserted between the working person and the party who acquires the services (the buyer);
   - the working person performs the services, but the associated entity derives the income;
   - the following threshold tests (discussed in detail in IS 19/02) are satisfied:
     - 80% or more of the associated entity's income from personal services during the income year is derived from the supply of services to the buyer, an associate of the buyer, or a combination of them;
     - 80% or more of the associated entity's income from personal services during the income year is derived from services that are performed by the working person, a relative of the working person, or a combination of them;
     - the working person's net income for the income year exceeds $70,000, including any amounts that would be attributed if the rule applied;
     - substantial business assets are not a necessary part of the business structure used to derive the entity's income from personal services; and
   - none of the exemptions in s GB 27(3) apply.

   The exemptions in s GB 27(3) are discussed in detail in IS 19/02, but in short, they cover the following situations:
   - the associated entity and the working person are non-residents;
   - the associated entity is a natural person, and is neither a partner of a partnership nor a trustee of a trust;
   - the services performed by the working person are essential support for a product supplied by the associated entity;
   - the amount to be attributed to the working person is less than $5,000 (though there are exclusions to this); and
   - various situations where the associated entity is a controlled foreign company.

Calculating the income to be attributed to the working person

The general rule

7. Once it is established that the attribution rule applies, it is necessary to calculate the amount of the entity's income that has to be attributed to the working person.

8. The general rule for this calculation is set out in s GB 29(1), which provides that the working person is treated as deriving **the lowest of three amounts** – described in paragraphs (a), (b) and (c):

   GB 29 Attribution rule: calculation

   Amount attributed

   (1) A working person is treated as deriving income in an income year equal to the least of the following amounts:

   (a) the associated entity's net income for the corresponding tax year, calculated as if their only income were derived from personal services:

   (b) the associated entity's net income for the corresponding tax year:

   (c) if and to the extent to which the associated entity is a company or a trust that has a loss balance to be carried forward under section IA 4 (Using loss balances carried forward to tax year) arising from a business or a trading activity of supplying personal services, the associated entity's net income for the corresponding tax year after subtracting the loss balance carried forward from an earlier corresponding tax year.

Which paragraph applies

9. It is not necessary to calculate each of the three amounts set out in s GB 29(1). Paragraphs (a), (b) and (c) cover different situations. Paragraph (a) (see from [22]) will be the relevant paragraph **unless**:

   - the entity has another business or activity that was loss-making in the particular tax year – in which case paragraph (b) will be relevant (see from [34]);

   OR

   - the entity has carried forward losses from a business or activity of supplying personal services – in which case paragraph (c) will be relevant (see from [42]).

What this Interpretation Statement covers

10. The discussion in this Interpretation Statement is set out as follows:

   - It explains the things that are taken into account or not taken into account in the income attribution calculations regardless of which of paragraphs (a), (b) or (c) is relevant (see from [11]).
   - Following that, there is more detailed discussion on:
     – Each of the calculation paragraphs:
   - Paragraph (a) – the general paragraph for calculating the attribution income, which is relevant except in (b) or (c) situations (see from [22]);
   - Paragraph (b) – which is relevant if the entity has another business or activity that was loss-making in the particular tax year (see from [34]); and
   - Paragraph (c) – which is relevant if the entity has carried forward losses from a business or activity of supplying personal services (see from [42]).
     – How to divide the attribution income where there is more than one working person (see from [50]).
     – How ignoring the look-through status of LTCs and partnerships works (see from [57]).
     – The treatment of dividends, if the entity is a company (see from [62]).
     – When FTCs can be claimed (see from [70]).
     – Other implications of income attribution (see from [76]).

Things specifically taken into account and not taken into account in the income attribution calculations

11. Section GB 29 sets out various things that are specifically either taken into account or not taken into account in the income attribution calculations.

12. The things **not taken into account** are:
    - the deduction the entity can claim for the amount of income attributed to the working person (see [14]);
    - distributions of beneficiary income, if the entity is a trust (see [15]); and
    - look-through status, if the entity is an LTC or a partnership (see from [16]).

13. The things **taken into account** are:
    - the salary the entity paid to the working person, and the taxable value of any fringe benefits the entity provided the person (see [18]);
    - distributions from the entity to the working person (see [19]); and
    - the market value of any unpaid administrative services provided by another person to the entity, if the entity is a partnership (see from [20]).

The entity's deduction for attributed income

14. When the attribution rule applies, the entity is allowed a deduction for the amount of income attributed to the working person (s DC 8). That deduction is ignored in calculating the entity's net income for the purposes of the attribution rule (s GB 29(1B)). This rule is necessary to ensure there is no circularity in the legislation or lack of clarity about what is included in the net income calculation.

Distributions of beneficiary income, if the entity is a trust

15. If the entity is a trustee of a trust, distributions of beneficiary income out of the particular tax year's income are generally ignored in calculating the entity's net income for the purposes of the attribution rule (s GB 29(2)). However, beneficiary income derived by the working person is taken into account (see [19]).

Look-through status, if the entity is an LTC or a partnership

16. If the entity is an LTC or a partnership, the provisions that provide for the transparency (or look-through status) of those entities do not apply in calculating the entity's net income for the purposes of the attribution rule (s GB 29(2)(b) and (c)). This means that in doing the attribution calculation, the LTC or partnership is treated as a taxpayer. The activities, property, arrangements, entitlements etc of the LTC or partnership are not treated as flowing through to the shareholders or partners, as they usually are.

17. There are some examples in the discussion from [57] showing how this ignoring of the look-through status of LTCs and partnerships works in practice.

The working person's salary and fringe benefits

18. The entity may pay the working person a salary, or provide them with benefits that are subject to the fringe benefit tax rules. In calculating the entity's net income for the purposes of the attribution rule, these are taken into account (s GB 29(3)). Specifically:
    - any employment income the entity paid to the working person during the income year; and
    - the taxable value of any fringe benefit that the entity provided or granted to the working person during the income year.

    See Example 2 on page 13.

Distributions from the entity to the working person

19. If the entity has made distributions to the working person, those are also taken into account in calculating the entity's net income for the purposes of the attribution rule (s GB 29(4)). The entity's net income under the attribution rule is reduced by:
    - **if the entity is a trustee of a trust**: the amount of any beneficiary income the working person derived from the trust in the income year;
    - **if the entity is a partnership**: the share of profits allocated to the working person by the partnership; and
    - **if the entity is a company**: the amount of any dividend the entity paid to the working person during the income year or within six months of the end of the year, provided it was paid from income derived in the income year. There is further discussion of the treatment of dividends from [62].

Market value of unpaid administrative services

20. If there are administrative services provided to the entity that have not been paid for, these may be taken into account under attribution rule. This will be the case where:
    - the entity is a partnership;
    - another person (not the working person) has provided the partnership with administrative services that relate to the partnership's income from personal services; and
    - the partnership has not paid for the administrative services.
21. In this situation, the amount to be attributed to the working person is reduced by the market value of the administrative services provided by the other person (s GB 29(5)). See Example 3 on page 14.

Paragraph (a) – the general income attribution calculation

22. As noted above, the amount of the entity's income that has to be attributed to the working person is the **lowest of the three amounts** described in paragraphs (a), (b) and (c) of s GB 29(1) – subject to some potential adjustments, as discussed in this Interpretation Statement.
23. As mentioned at [9], paragraph (a) will be the relevant paragraph **unless**:
    - the entity has another business or activity that was loss-making in the particular tax year – in which case paragraph (b) will be relevant (see from [34]); or
    - the entity has carried forward losses from a business or activity of supplying personal services – in which case paragraph (c) will be relevant (see from [42]).
24. If neither of those circumstances are the case and paragraph (a) applies, the amount to be attributed is:

    (a) **the associated entity's net income for the corresponding tax year, calculated as if their only income were derived from personal services:**

    [Emphasis added]

25. However, bear in mind that the amount to be attributed to the working person may be reduced further in two situations:
    - if the entity is a partnership, and another person provides administrative services to the partnership but these have not been paid for (if this is relevant, see from [20]); or
    - if there is more than one working person – in which case the attribution income needs to be divided between the working persons (if this is relevant, see from [50]).
26. So, the starting point for paragraph (a) is determining the amount that would be the entity's net income, calculating the net income as if the entity's only income were derived from personal services.
27. If the only income the entity derives is from supplying the services that are performed by the working person, the net income under paragraph (a) is simply the entity's net income for the year.
28. However, if the entity carries on another income-earning activity as well, there may be some costs in each of the following categories:
    - costs that relate only to earning the personal services income;
    - costs that relate only to earning the other (non-personal services) income; and
    - costs that relate to earning both the personal services income and the other income.
29. Costs that relate only to earning the personal services income are therefore clearly included in the paragraph (a) net income calculation, and costs that relate only to earning the other (non-personal services) income are clearly not included.
30. However, there are two approaches that could be taken for costs that relate to earning both the personal services income and the other income (ie, the entity's overhead costs). One approach would be to apportion these "mixed expenses" between the personal services income earning activity and the other income earning activity, and then work out what part of the entity's net income relates to the personal services activity. The other approach would be to include in the net income calculation any costs that would have been incurred irrespective of the non-personal services income earning activity.
31. The Commissioner's view is that paragraph (a) takes the second approach. Paragraph (a) does not contain words to indicate that apportionment is required, like "to the extent that", which other provisions in the Act do. What paragraph (a) requires is a hypothetical consideration of what the entity's net income would be had it earned only the personal services income. As such, there is no need to apportion "mixed expenses"; they are included in the net income calculation if they would have been incurred irrespective of the non-personal services income earning activity (eg, the cost of renting premises used for both activities).

32. The Commissioner does not consider that this requires consideration of whether the entity would have incurred the same overheads if the only income earning activity was the supply of the personal services. The hypothetical net income calculation just excludes costs that solely relate to the non-personal services income. It does not require a hypothetical consideration of what overhead costs the entity would have incurred if it derived only the personal services income (eg, if it would have leased a smaller office space).

33. There may be situations where an expense, or a component of an expense, can be identified as relating solely to one income earning activity or another. In that situation, that expense or component would not be a mixed expense. An example of this are some motor vehicle costs, where the vehicle is used for both income earning activities. There are some fixed costs in relation to the vehicle – eg, registration, warrants of fitness, and insurance. Those costs would be included in the net income calculation under paragraph (a), as they would be incurred irrespective of the non-personal services income earning activity. However, there are also some costs in relation to the vehicle that are attributable to usage – eg, petrol, and usage related repairs such as tyre replacement. Those costs should be apportioned between the different business uses of the vehicle (based on mileage), with only the portion that relates to the personal services income taken into account in the paragraph (a) net income calculation.

Example 1 – Two income earning activities – treatment of overheads

The attribution rule applies to Company A, which supplies services performed by Jane (the working person). Company A also carries on another income earning activity. Under paragraph (a), Company A's net income would be calculated as follows:

Company A – income	
Income from the supply of personal services	$150,000
Income from the other activity	$120,000
Company A – expenses	
Expenses solely related to the personal services income	$5,000
Expenses solely related to the other activity	$3,000
Office overheads	$20,000
Net income for the attribution rules, under paragraph (a)	
Income from the supply of personal services	$150,000
Less:	
Expenses solely related to the personal services income	$5,000
Office overheads	$20,000
Equals:	
Net income under (a), to be attributed to Jane	**$125,000**

Example 2 – Two income earning activities – salary paid to working person

This example is based on Example 1, but Jane is paid a salary of $80,000.

Company A – income	
Income from the supply of personal services	$150,000
Income from the other activity	$120,000
Company A – expenses	
Expenses solely related to the personal services income	$5,000
Expenses solely related to the other activity	$3,000
Office overheads	$20,000
General salary paid to Jane	$80,000
Net income for the attribution rules, under paragraph (a)	$150,000
Income from the supply of personal services	$150,000
Less:	$5,000
Expenses solely related to the personal services income	$5,000
Office overheads	$20,000
Salary paid to Jane	$80,000
Equals:	
Net income under (a), to be attributed to Jane	**$45,000**

The salary paid to Jane is taken into account in the calculations whether it relates solely to her performing the personal services or not. Employment income the entity pays to the working person is one of the specific things s GB 29 says is to be taken into account in calculating the entity's net income for the purposes of the attribution rule (s GB 29(3)) – see [18].

Example 3 – Two income earning activities – salary paid to working person and unpaid administrative services

This example is based on Example 1, but:

- the entity is a partnership;
- Jane is paid a salary of $80,000; and
- Jane's partner Nick provides administrative services for the partnership but is not paid for those services.

The market value of the administrative services Nick provides in relation to the personal services income the partnership derives (from the work Jane does) is $15,000.

Partnership income	
Income from the supply of personal services	$150,000
Income from the other activity	$120,000
Partnership expenses	
Expenses solely related to the personal services income	$5,000
Expenses solely related to the other activity	$3,000
Office overheads	$20,000
General salary paid to Jane	$80,000
Net income for the attribution rules, under paragraph (a)	$150,000
Income from the supply of personal services	$150,000
Less:	$5,000
Expenses solely related to the personal services income	$5,000
Office overheads	$20,000
Salary paid to Jane	$80,000
Market value of the unpaid administrative services Nick provides in relation to the personal services income	$15,000
Equals:	
Net income under (a), to be attributed to Jane	**$30,000**

The market value of the administrative services Nick provides the partnership in relation to the personal services income is taken into account in the calculations because Nick has not been paid for those services. Unpaid administrative services provided to a partnership are one of the specific things s GB 29 says are to be taken into account in calculating the entity's net income for the purposes of the attribution rule, if certain requirements are met (s GB 29(5)) – see [20].

Paragraph (b) – where the entity has a separate loss-making activity

34. As mentioned at [9], paragraph (b) is the relevant paragraph for calculating the income to be attributed to the working person in situations where the entity has:
    - income from supplying personal services; and
    - another business or activity that was loss-making in the tax year.
35. Where paragraph (b) applies, the amount to be attributed is:

    (b) **the associated entity's net income for the corresponding tax year:**

    [Emphasis added]
36. However, again, bear in mind that the amount to be attributed to the working person may be reduced further in two situations:
    - if the entity is a partnership, and another person provides administrative services to the partnership but these have not been paid for (if this is relevant, see from [20]); or
    - if there is more than one working person – in which case the attribution income needs to be divided between the working persons (if this is relevant, see from [50]).
37. The net income calculation under paragraph (b) does not just take into account expenses that the entity would have incurred if its only income earning activity was the supply of personal services, as the calculation under paragraph (a) does. The net income under paragraph (b) is simply the entity's net income for the tax year. All allowable deductions that are allocated to an income year come into a person's net income – this is discussed further from [39].
38. The effect of paragraph (b) is to reduce the income to be attributed to the working person in most situations where the entity carries on another activity that is loss-making in the year. The rationale for allowing the loss-making activity to be taken into account is that in many cases the loss would be able to be accessed and used by the working person anyway (ie, through the LTC or partnership rules).

Example 4 – Personal services income and loss-making share-trading activity

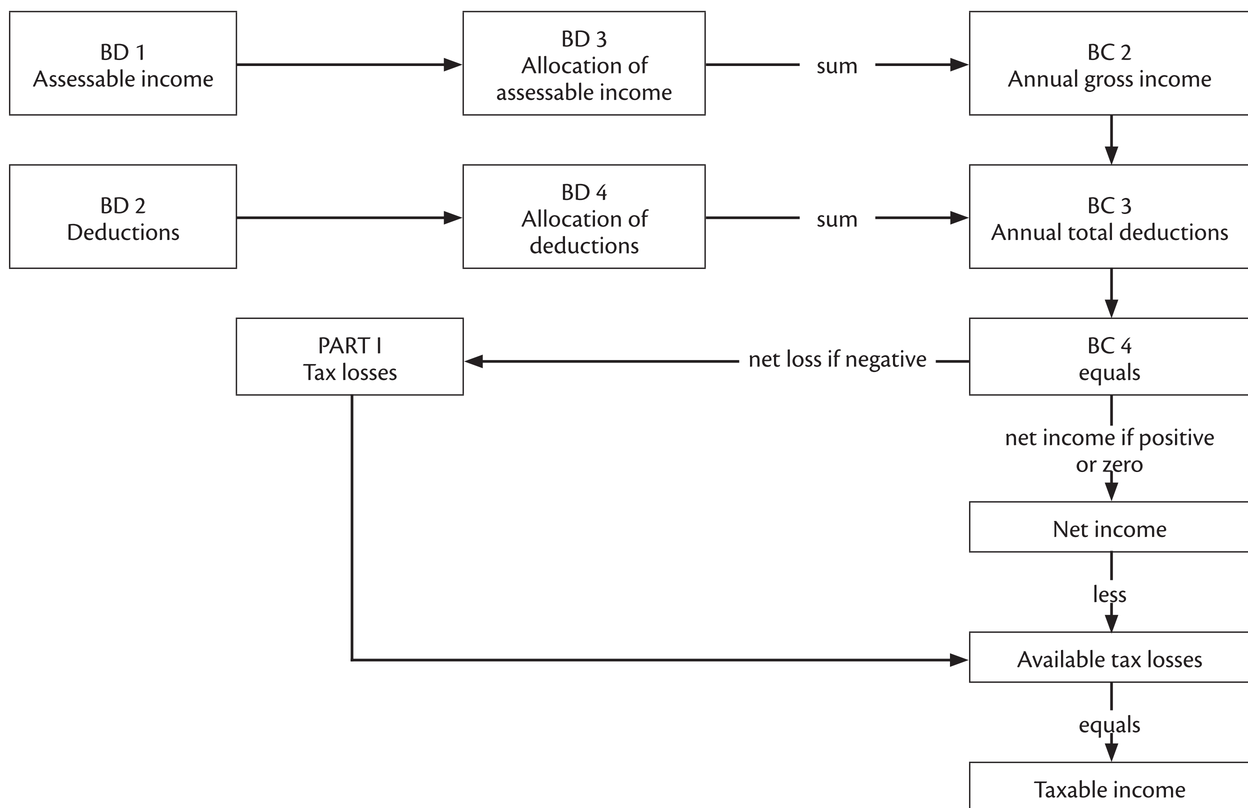
The attribution rule applies to Company B, which is an LTC. Company B supplies services performed by Jeremy (the working person), and also trades shares. The share trading activity is loss-making this tax year. Under paragraph (b), Company B's net income would be calculated as follows:

Company B – income	
Income from the supply of personal services	$150,000
Income from the sale of shares	$80,000
Company B – expenses	
Expenses solely related to the personal services income	$10,000
Deductions in relation to the share trading activity	$100,000
Net income for the attribution rules, under paragraph (b)	
Total income	$230,000
($150,000 income from the supply of personal services + $80,000 income from the sale of shares)	
Minus:	
Total deductions	$110,000
($10,000 in relation to the personal services income + $100,000 in relation to the share trading activity)	
Equals:	
Net income under (b), to be attributed to Jeremy	**$120,000**

Under the paragraph (a) calculation – in which the entity's net income is calculated as if the entity's only income were from personal services – the attribution income would be $140,000 ($150,000 less $10,000). However, paragraph (b) is relevant here because Company B has a share trading loss. The effect of paragraph (b) is to allow the share trading loss ($20,000) to reduce the income attributable to Jeremy.

39. It is important to note that not all loss-making activities will be taken into account in the paragraph (b) calculation. This is because not all loss-making activities will affect a person's (in this case the entity's) net income. There are deduction allocation rules that apply in some situations to limit the deductions that are allocated to an income year if a particular activity is loss-making. Examples of this are the ring-fencing rules for residential rental property deductions (in Subpart EL), the bright-line expenditure quarantine rules (in s EL 20), and the mixed-use asset expenditure quarantine rules (in ss DG 15 to DG 19).
40. In addition, tax losses carried forward from an earlier income year are not taken into account in the paragraph (b) calculation. Only current year loss-making activities come into the calculation. This is because available tax losses from earlier years do not reduce a person's net income; rather, they are deducted from net income in calculating the person's taxable income. If the entity has losses carried forward from an earlier year, these can potentially be taken into account in calculating the income to be attributed to the working person – but *only if the loss is from a business or trading activity of supplying personal services*. This situation is covered by paragraph (c), which is discussed from [42].
41. "Net income" – which is what paragraph (b) is concerned with – is calculated by deducting **annual total deductions** from **annual gross income**, as shown in the diagram below:

Figure 1 - Calculating net income under the core provisions



Example 5 – Personal services income and loss-making residential rental property

The attribution rule applies to Company C, which is an LTC. Company C supplies services performed by Kirsten (the working person), and owns a residential rental property. The rental property is loss-making this tax year, and is subject to the ring-fencing rules in Subpart EL. Under paragraph (b), Company C's net income would be calculated as follows:

Company C – income	
Income from the supply of personal services	$200,000
Income from the rental property	$40,000
Company C – expenses	
Expenses solely related to the personal services income	$15,000
Expenses in relation to the rental property	$50,000
Net income for the attribution rules, under paragraph (b)	
Total income	$240,000
($200,000 income from the supply of personal services + $40,000 income from the rental property)	
Minus:	
Total deductions allocated to the income year	$55,000
($15,000 in relation to the personal services income + $40,000 in relation to the rental activity (s EL 4))	
Equals:	
Net income under (b), to be attributed to Kirsten	**$185,000**

In this situation, the result under paragraph (b) is the same as it would be under paragraph (a). This is because the rental property deductions are only allocated to the income year up to the amount of rental income for the year (s EL 4). To the extent the property deductions exceed the rental income ($10,000), they are suspended as a deduction for the income year and carried forward to the next year that Company C derives income from residential property. Because the excess rental property deductions are *not allocated to the income year*, they do not come into Company C's **net income** for the year. The fact that the rental property is loss-making therefore does not reduce the income attributable to Kirsten.

Paragraph (c) – where the entity has carried forward losses from supplying personal services

42. As mentioned at [9], paragraph (c) is the relevant paragraph for calculating the income to be attributed to the working person in situations where the entity has carried forward losses from a business or activity of supplying personal services.

43. Where paragraph (c) applies, the amount to be attributed is:

> (c) if and to the extent to which the associated entity is a company or a trust that has a loss balance to be carried forward under section IA 4 (Using loss balances carried forward to tax year) arising from a business or a trading activity of supplying personal services, **the associated entity's net income for the corresponding tax year after subtracting the loss balance carried forward from an earlier corresponding tax year**.
>
> [Emphasis added]

44. However, again, bear in mind that the amount to be attributed to the working person may be reduced further in two situations:

- if the entity is a partnership, and another person provides administrative services to the partnership but these have not been paid for (if this is relevant, see from [20]); or
- if there is more than one working person – in which case the attribution income needs to be divided between the working persons (if this is relevant, see from [50]).

45. The attribution income calculation under paragraph (c) takes into account the entity's net income for the year (this is discussed from [34] – it is the amount that would be attributed under paragraph (b)) but **in addition** allows for the subtraction of carried forward personal services losses.

46. This means that the paragraph (c) calculation will include both:

- current year loss-making activities, whether from the personal services activity or not (provided these come into the entity's net income for the year – see from [39]); and
- carried forward prior year losses, provided they are from a business or activity of providing personal services.

47. For carried forward losses to be subtracted from the entity's net income under paragraph (c), the entity must:
    - be a company or a trust; and
    - have a loss balance carried forward under s IA 4 that arises from a business or trading activity of supplying personal services.
48. This means that the entity cannot subtract carried forward losses it has from some *other* business activity, not involving the supply of personal services. It is only carried forward losses that relate to supplying personal services that are taken into account under paragraph (c).
49. It is generally unlikely that there would be losses generated from a business of supplying personal services. But this could be the case, for example where the entity is going through a start-up process and the business of supplying personal services is not profitable early on. In that situation, the losses arising from the personal services business can offset the income in subsequent years, reducing the amount attributable to the working person.

How to divide the attribution income where there is more than one working person

50. If the personal services are performed by more than one person associated with the entity, the amount to be attributed needs to be split between the working persons. The requirement for this is set out in s GB 29(7), which says:

    Attribution to more than 1 working person

    (7) If the amount attributable is to be attributed to more than 1 working person, **the share attributed to each working person must reflect the respective value of the services personally performed by each working person**.

    [Emphasis added]
51. There are no statutory rules for determining the respective value of the services each working person performs. The most appropriate method of determining the respective value of the services performed by each working person will depend on the particular circumstances.
52. If the working persons perform the same type of services, to the same standard, the relative working hours might provide an appropriate method of determining the value each provides. However, there could be situations where the working persons provide the same type of services, but the respective value of what each of them provides is different. For example, the working persons may be in the same profession and providing professional services through the entity, but one may have substantially more experience and expertise than the other. In this case, it would be appropriate to take into account both the hours worked and the relative value of the work done by each person. It may be that there are different charge-out rates for the work done by each person – if so this may be an appropriate basis for determining the respective value of the services each person performs, providing the charge-out rates accurately reflect the value of the work each does.
53. Similarly, if the working persons perform different types of services, the relative value of the different services performed will need to be determined. Again, respective charge-out rates and hours worked may be an appropriate way to a determine the respective value of the services each person performs.
54. Another method might be to look at the market rates charged for the type of work each person performs, and apply those rates to the hours worked. This might be the most appropriate method where the services are provided on a fixed-fee basis.
55. The Commissioner will accept any reasonable basis for determining the respective value of services provided by the working persons. The methods above are just examples of possible approaches – the particular circumstances may indicate a different method is more appropriate.
56. Once the respective values of the services provided by each working person have been ascertained, the amount of the entity's income to be attributed (calculated under paragraph (a), (b) or (c), as explained in this Interpretation Statement) should be split between the working persons in proportion to the relative value each provides.

Example 6 – Attribution of income to more than one working person

The attribution rule applies to Company D, which supplies engineering services performed by Michael and draughting services performed by Michael's partner Katie. The company does not carry on any other income earning activity and does not have any carried forward losses. Paragraph (a) is therefore the relevant paragraph for calculating the amount to be attributed under the attribution rule. Because the only income the company derives is from supplying the engineering services, the net income under paragraph (a) is simply the company's net income for the year. This is calculated as follows:

Company D – income	
Income from the supply of service	$348,000
Company D – expenses	
Office overheads	$5,000
Transport	$3,000
Salary paid to Michael	$70,000
Salary paid to Katie	$30,000
Net income for the attribution rules, under paragraph (a)	
Income from the supply of services	$348,000
Less:	
Office overheads	$5,000
Transport	$3,000
Salary paid to Michael	$70,000
Salary paid to Katie	$30,000
Net income under (a), to be attributed to the working persons	**$240,000**

Because Michael and Katie are both working persons, the amount attributable ($240,000) needs to be split between them. This split has to reflect the respective value of the services they each perform.

Company D's clients may be charged the standard market rate for engineering services provided by Michael which is $200 per hour, and the standard market rate for draughting services provided by Katie which is $100 per hour. Alternatively, clients may be charged an overall hourly rate of $150. The hourly rate of $150 is a flat rate – there is no breakdown and therefore no indication of different rates charged for different aspects or different input services for the work performed.

During the year, all of Company D's clients were charged the overall hourly rate of $150. The total hours the company billed for the year was 2,320, from which the company derived income of $348,000 (ie, 2,320 hours x $150 per hour).

Under the attribution rule, Company D needs to determine the respective value of the services Michael and Katie performed. The company does this based on the rates that are charged out (if the client opts to be billed on that basis) for the different types of work Michael and Katie perform, and the hours each of them worked during the year.

During the year, Michael worked 1,600 hours and Katie worked 720 hours. Based on these hours of work and the market rates Company D charges for the different types of work (if clients prefer that to a flat hourly rate), Company D calculates the respective value of the services Michael and Katie worked as follows:

Michael: 1,600 hours × $200 = $320,000
Katie: 720 hours × $100 = $72,000

Based on the respective value of the work performed by each of Michael and Katie, the amount of Company D's income ($240,000) to be attributed should be split between them in the following proportions:

Michael: $\frac{320,000}{392,000} \times 100 = 81.63\%$

Katie: $\frac{72,000}{392,000} \times 100 = 18.37\%$

As a result, **$195,912** of Company D's income is attributed to **Michael** (81.63% of $240,000), and **$44,088** is attributed to **Katie** (18.37% of $240,000).

The extent to which the look-through status of LTCs and partnerships is ignored

57. As noted at [11], s GB 29 sets out various things that are specifically either taken into account or not taken into account in the income attribution calculations. One of the things not taken into account, if the entity is an LTC or a partnership, is the look-through status the entity would otherwise have for tax purposes.

58. Under the LTC rules (in Subpart HB) and the partnership rules (ss HG 2 to HG 12), LTCs and partnerships are treated as transparent for tax purposes. The income, deductions, losses etc are passed through to the holders of look-through interests in the company or partners in the partnership, in proportion to their effective look-through interest or partnership share. In addition, the holders of look-through interests or partners are treated as carrying on any activity carried on by the entity; having the status, intention or purpose the entity has; holding property the entity holds; being party to the entity's arrangements; and doing or being entitled to anything the entity does or is entitled to. Essentially, these rules put the shareholders or partners in the shoes of the LTC or partnership for tax purposes.

59. The reason the attribution rule overrides these tax transparency provisions is that otherwise the income flowing to the working person (shareholder or partner) would be based on their shareholding or partnership interest, not on the amount of income that is rightly attributable based on the work they have performed. In particular, the aims of the attribution rule could be thwarted where there are more shareholders or partners than working persons, or where there is disparity between the value of the personal services provided by the working person and the income that would flow to them under the LTC or partnership rules based on their shareholding or partnership interest relative to that of others.

60. Example 7 shows how the tax treatment under the attribution rule differs to what the position would be under the LTC rules or partnership rules.

Example 7 – Treatment under the attribution rule compared with under the LTC rules

The attribution rule applies to Company E, an LTC that supplies services performed by Kamal (the working person). Kamal and Priti hold equal effective look-through interests in Company E.

Table 1 shows the income that would flow through to Kamal and Priti ordinarily under the LTC rules, and what instead happens under the attribution rule.

Table 1 - Difference of treatment between LTC rules and attribution rule

	Under the LTC rules (no attribution) ($000)	Under the attribution rule ($000)
Income from personal services	150	150
Deductions	50	50
Pre-allocation income	100	100
Income to Kamal (50% shareholder/working person)	50	100
Income to Priti (50% shareholder/non-working person)	50	0

61. It is important to note that the tax transparency of LTCs and partnerships is only overridden for the purposes of calculating the entity's net income under s GB 29(1) (the general attribution calculations). LTCs and partnerships are still transparent for other tax purposes. The following example (Example 8) demonstrates this.

Example 8 – LTC transparency overridden only in applying the attribution rule; not for all tax purposes

This example assumes the same facts as in Example 7, but in addition Company E derives income from the sale of land that was acquired with the intention of resale (s CB 6).

Table 2 shows the income that would flow through to Kamal and Priti under the attribution rule and the LTC rules – the LTC's tax transparency only being overridden in relation to the attribution calculation, not the land sale income and deduction.

Table 2 – Interaction of attribution rule and LTC rules where there is attributable income as well as income not subject to the attribution rule

	($000)
Income from personal services	150
Deductions relating to personal services	50
Pre-allocation personal services income	100
Income from land sale	1400
Deduction relating to land sale	1000
Income to Kamal (50% shareholder/working person)	**800** (100 attributed in respect of personal services provided + 700 from the land sale)
Deduction to Kamal	**500**
Income to Priti (50% shareholder/non-working person)	**700**
Deduction to Priti	**500**

Treatment of dividends

62. Where the entity is a company, it will at some stage distribute the cash that has been attributed as income to the working person. There are specific rules the company may be able to choose to apply in this situation, to ensure the attributable income is not subject to double taxation – once in the hands of the working person (when it is attributed to them) and again in the hands of the shareholder (when a dividend is paid to them).

63. These rules are set out in s GB 27(4), which provides:

Treatment of certain dividends

(4) If a company that is required to attribute an amount to the working person under this section and section GB 29 pays a dividend, sections HA 14 to HA 19 (which relate to qualifying companies) are treated as applying to the company and the dividend if—

(a) the dividend is paid—

(i) no earlier than the end of 6 months after the end of the income year referred to in subsection (1); and

(ii) from income that has been attributed to the working person under this section and section GB 29; and

(b) the company,—

(i) for each tax year that corresponds to an income year in which it derived income from which it pays the dividend, has no net income other than income attributed under this section and section GB 29, ignoring interest income that is incidental to the company's business; and

(ii) is not a qualifying company; and

(iii) chooses to have the dividend treated as if it were paid by a qualifying company; and

(iv) keeps sufficient records to enable the Commissioner to verify the matters referred to in paragraph (a).

64. Under these rules, the treatment of dividends paid by the company differs depending on whether the dividend is paid:

- during the income year in which the attributable income was derived and is to be attributed, or within six months of the end of that year (referred to in this Interpretation Statement as an "**in-year dividend**"); or
- later than six months after the end of the income year in which the attributable income was derived and is to be attributed (referred to in this Interpretation Statement as a "**post-year dividend**").

65. Effectively, a "post-year dividend" is tax free in the hands of the shareholder, provided it is paid from income that has previously been attributed to the working person.

66. In contrast an "in-year dividend" is taxable in the hands of the shareholder, but deductible to the company when calculating its net income for the purposes of the attribution rule (s GB 29(4)).

67. For these rules to apply, the company has to:
    - have had no net income other than income that is attributed under the attribution rules for each year in which it derived income that the dividend is paid from (interest income that is incidental to the company's business is ignored);
    - not be a qualifying company;
    - choose this treatment; and
    - keep sufficient records for the Commissioner to be able to confirm that the requirements have been met.

Post-year dividends

68. The following example (Example 9) shows the tax treatment of a "post-year dividend", which is paid from income attributed to the working person in an earlier year.

    Note: *There are two special rules for calculating imputation credits/debits that apply to companies subject to the attribution rule. These are set out in ss OB 16 and OB 40. In Examples 9 and 11 below, the imputation credit and debit amounts have been calculated in accordance with those rules.*

Example 9 – "Post-year dividend" in year two, distributing year one attribution income

This example shows the tax consequences when the company pays a "post-year dividend" to the shareholder (who is also the working person) to distribute the income that was attributed to the working person in an earlier year. In this example, all the shares in the company are owned by the working person.

In the example, there was no dividend paid in year one. All of the income in year one was taxed in the hands of the working person (either as salary or attribution income) at 33%.

In year two, the company distributes the previously taxed attribution income to the working person, by paying a "post-year dividend" that is sourced from year one attribution income. The working person is also paid a salary and derives attribution income.

The tax consequences for the company and for the shareholder working person are as shown in Table 3.

Table 3 – "Post-year dividend" distributing attribution income from an earlier year

Tax consequences for the company: year one	**($000)**
Pre-attribution (net) income of the company	150
Salary paid to working person (s GB 29(3))	(80)
Net income of the company to be attributed (s GB 29(1)(a))	70
Deduction for amount of attributed income (s DC 8)	(70)
Amount of imputation credit (s OB 16)	27
Amount of imputation debit (s OB 40)	(27)
Balance of imputation credit account	0
Taxable income	0

Note: The company now has $70,000 available to pay out as a "post-year dividend"

Tax consequences for the company: year two	
Pre-attribution (net) income of the company	120
Salary paid to working person (s GB 29(3))	0
Net income of the company to be attributed (s GB 29(1)(a))	120
Deduction for amount of attributed income (s DC 8)	(120)
Amount of imputation credit (s OB 16)	47
Amount of imputation debit (s OB 40)	(47)
Balance of imputation credit account	0
Taxable income	0

Note: Non-deductible "post-year dividend" paid to working person out of year one attribution income 60

The company now has $130,000 available to pay out as a "post-year dividend" ($10,000 from year one attribution income and $120,000 from year two attribution income)

Tax consequences for the working person: year one	
Salary	80
Attribution income (s GB 29 and s CE 8)	70
Taxable income	150
Tax at 33%*	(50)
After tax income	100

Note: The above table reflects the **tax position** for the working person. PAYE has been deducted from the working person's salary of $80,000, but the working person will need to pay the additional tax required.

Tax consequences for the working person: year two	
Salary	0
Attribution income (s GB 29 and s CE 8)	120
"Post-year dividend"	60
Imputation credit account credit (s HA 15(4), s OB 40, s OB 16)	0
Less exempt "post-year dividend" (s GB 27(4) and s HA 14(2)	*(60)*
Taxable income	120
Tax at 33%*	(40)
After tax income	80

Note: The above table reflects the tax position for the working person. The working person has $60,000 of cash from the dividend paid, and needs to pay $40,000 tax, after which they will have $20,000 cash in hand.

* 33% is assumed to be the applicable tax rate for the purposes of this example

Example 10 – "Post-year dividend" paid in year two, distributing year one attribution income to working and non-working person shareholders

This example shows the tax consequences when the company pays a "post-year dividend" to distribute the income that was attributed to the working person in an earlier year. The dividend is paid to both of the two shareholders of the company, one of whom is the working person.

In the example, there was no dividend paid in year one. All the income in year one was taxed in the hands of the working person (either as salary or attribution income) at 33%.

In year two, the company distributes the previously taxed attribution income equally between the two shareholders, by paying a "post-year dividend" that is sourced from year one attribution income. The working person was not paid a salary and derives only attribution income from the company.

The tax consequences for the company and for both shareholders are as shown in Table 4. For simplicity, this example does not consider the imputation credit position of the company or shareholders.

Table 4 – "Post-year dividend" to both shareholders, distributing attribution income from an earlier year

Tax consequences for the company: year one	**($000)**
Pre-attribution (net) income of the company	150
Salary paid to working person (s GB 29(3))	0
Net income of the company to be attributed (s GB 29(1)(a))	150
Deduction for amount of attributed income (s DC 8)	(150)
Taxable income	0

Note: The company now has $150,000 available to pay out as a "post-year dividend"

Tax consequences for the company: year two	
Pre-attribution (net) income of the company	120
Salary paid to working person (s GB 29(3))	0
Net income of the company to be attributed (s GB 29(1)(a))	120
Deduction for amount of attributed income (s DC 8)	(120)
Taxable income	0

Note: Non-deductible "post-year dividend" paid to both shareholders out of year one attribution income (75 distributed to each shareholder) 150

The company now has $120,000 available to pay out as a "post-year dividend"

Tax consequences for the working person shareholder: year one	
Salary	0
Attribution income (s GB 29 and s CE 8)	150
Taxable income	150
Tax at 33%*	(50)
After tax income	100

Tax consequences for the working person shareholder: year two	
Salary	0
Attribution income (s GB 29 and s CE 8)	120
"Post-year dividend"	*75*
Less exempt "post-year dividend" (s GB 27(4) and s HA 14(2)	*(75)*
Taxable income	120
Tax at 33%*	(40)
After tax income	80

Note: The above table reflects the **tax position** for the working person. The working person has $75,000 of cash from the dividend paid, and needs to pay $40,000 tax, after which they will have $35,000 cash in hand.

Tax consequences for the non-working person shareholder: year two	150
"Post-year dividend"	75
Less exempt "post-year dividend" (s GB 27(4) and s HA 14(2)	(75)
Taxable income	0
Tax at 33%*	0
After tax income	75

* 33% is assumed to be the applicable tax rate for the purposes of this example

In-year dividends

69. The following example (Example 11) shows the tax treatment of an "in-year dividend", which is paid from the company's pre-attribution income, during the income year the attributable income was derived or within six months of the end of the year.

Example 11 – distributing some of the pre-attribution income by way of an "in-year dividend

This example shows the tax consequences when the company distributes some of its pre-attribution income by way of an "in-year dividend" paid to the shareholder (who is also the working person). There is also a "post-year dividend" paid, sourced from prior year attribution income that was taxed in the hands of the working person. In this example, all the shares in the company are owned by the working person.

The tax consequences for the company and for the shareholder working person are as shown in Table 5.

Table 5 – Distributing some of the pre-attribution income by way of an "in-year dividend"

Tax consequences for the company	**($000)**
Pre-attribution (net) income of the company	150
Salary paid to working person (s GB 29(3))	(80)
Deductible "in-year dividend" paid to working person (s GB 29(4))	(50)
Net income of the company to be attributed (s GB 29(1)(a))	20
Deduction for amount of attributed income (s DC 8)	(20)
Amount of post-attribution income	0
Amount of imputation credit (s OB 16)	8
Amount of imputation debit (s OB 40)	(8)
Balance of imputation credit account	0

Note: Non-deductible "post-year dividend" paid to working person from prior year attribution income 25
The company now has $20,000 available to pay out as a "post-year dividend"

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Salary	80
Attribution income (s GB 29 and s CE 8)	20
"In-year dividend"	50
"Post-year dividend"	25
Less exempt "post-year dividend" (s GB 27(4) and s HA 14(2)	(25)
Imputation credit account credit (s HA 15(4), s OB 40, s OB 16)	0
Taxable income	150
Tax at 33%*	(50)
After tax income	100

Note: The above table reflects the **tax position** for the working person. PAYE has been deducted from the working person's salary of $80,000, but the working person will need to pay the additional tax required.

* 33% is assumed to be the applicable tax rate for the purposes of this example

Example 12 – distributing some of the pre-attribution income by way of an "in-year dividend" to the shareholders (one the working person and the other a non-working person)

This example shows the tax treatment of an "in-year dividend", which is paid from the company's pre-attribution income during the year the attributable income was derived. The dividend is paid to the two shareholders of the company, one of whom is the working person. The working person was not paid a salary and derives only attribution income from the company.

The tax consequences for the company and for both shareholders are as shown in Table 6. For simplicity, this example does not consider the imputation credit position of the company or shareholders.

Table 6 – Distributing pre-attribution income by way of an "in-year dividend" to both shareholders

Tax consequences for the company	**($000)**
Pre-attribution (net) income of the company	150
Deductible "in-year dividend" paid to working person (s GB 29(4))	(75)
Net income of the company to be attributed (s GB 29(1)(a))	75
Deduction for amount of attributed income (s DC 8)	(75)
Amount of post-attribution income	0

Note: The company now has $75,000 available to pay out as a "post-year dividend

Tax consequences for the working person shareholder	
Attribution income (s GB 29 and s CE 8)	75
"In-year dividend"	75
Taxable income	150
Tax at 33%*	(50)
After tax income	100

Note: The above table reflects the **tax position** for the working person. The working person has $75,000 of cash from the dividend paid, and needs to pay $50,000 tax, after which they will have $25,000 cash in hand.

Tax consequences for the non-working person shareholder	
"In-year dividend"	75
Taxable income	75
Tax at 33%*	(25)
After tax income	50
After tax income	100

Note: The above table reflects the **tax position** for the non-working person. The non-working person has $75,000 of cash from the dividend paid, and needs to pay $25,000 tax, after which they will have $50,000 cash in hand.

* 33% is assumed to be the applicable tax rate for the purposes of this example

When FTCs can be claimed

70. The attribution rule may apply in relation to income from services performed overseas. This is because the s GB 27(3)(a) exemption from the attribution rule will only apply if the entity and the working person are **both** non-resident in New Zealand at all times during the relevant income year.

71. There are some examples showing when the s GB 27(3)(a) will apply or not apply in IS 19/02 (see from [16] of that Interpretation Statement). However, those examples did not go into whether the working person could claim FTCs in relation to tax paid by the entity.

72. The rules in relation to FTCs in this situation are set out in s LJ 2, which provides (relevantly):

LJ 2 Tax credits for foreign income tax

Amount of credit

(1) A person described in section LJ 1(2)(a) has a tax credit for a tax year for an amount of foreign income tax paid on a segment of foreign-sourced income, determined as if the segment were the net income of the person for the tax year. The amount of the New Zealand tax payable is calculated under section LJ 5.

…

When subsections (9) and (10) apply

(8) Subsections (9) and (10) apply **when a person (the associated entity) resident in New Zealand** derives an amount (the attributed amount) that—

(a) **is assessable income of the associated entity that is sourced from outside New Zealand**; and

(b) **is attributed under sections GB 27 to GB 29** (which relate to the attribution rule for income from personal services) in an income year **to another person (the working person) who is resident in New Zealand when the associated entity derives the attributed amount**.

Tax credit: attributed income from personal services

(9) Despite section LJ 1(2)(a), **the working person has a tax credit under this subpart for foreign income tax paid on the attributed amount by the associated entity or withheld in relation to the attributed amount**. The calculation of the maximum amount of the tax credit is made under section LJ 5(2), modified so that the item segment in the formula is the attributed amount for the income year.

No tax credit for associated entity

(10) **The associated entity does not have a tax credit under this subpart for foreign income tax paid on or withheld in relation to the attributed amount**.

[Emphases added]

73. The effect of the above provisions is that:
    - the working person can claim an FTC for tax paid by the associated entity on foreign sourced income that is attributed to the working person; and
    - the associated entity cannot claim an FTC for that amount.

74. The requirements for this to be the case are that:
    - the associated entity is tax resident in New Zealand;
    - the associated entity derived assessable income sourced outside New Zealand;
    - the amount of foreign sourced income is attributed to the working person; and
    - the working person was tax resident in New Zealand when the entity derived the attributed amount.

75. The following examples (Example 13 and Example 14) show when a working person can claim an FTC in relation to tax paid by the entity. They replicate the facts from Example 3 and Example 4 in IS 19/02, but look only at the FTC issue.

Example 13 – FTCs not claimable; the working person is not tax resident in New Zealand

John is a non-resident who owns all of the share capital of NZCO, which is a New Zealand incorporated company. John is the working person and NZCO is the associated entity. NZCO provides consulting services to one buyer – an Australian company. The services are provided to the buyer in Australia and the work is done by John in Australia.

The income attribution rule applies. This is discussed in Example 3 in IS 19/02.

In this situation, John cannot claim any FTCs in relation to tax paid by NZCO in Australia. This is because John was not tax resident in New Zealand when the entity derived the attributed amount.

Example 14 – FTCs claimable; all requirements met

Michelle is New Zealand tax resident who is living in France. She owns all of the share capital of NZCO, which is a New Zealand incorporated company. Michelle is the working person and NZCO is the associated entity. NZCO provides consulting services to FranceCo, which is the sole buyer of the services that NZCO provides. Michelle provides the services in France.

The income attribution rule applies. This is discussed in Example 4 in IS 19/02.

In this situation, Michelle can claim FTCs in relation to tax paid by NZCO in France. This is because:

- NZCO is tax resident in New Zealand;
- NZCO derived assessable income sourced outside New Zealand;
- the amount of foreign sourced income is attributed to Michelle under the attribution rule; and
- Michelle was tax resident in New Zealand when NZCO derived the attributed amount.

Other implications of the income attribution rule

Child support, student loans, and Working for Families

76. As noted at [3], the attribution rule ensures that taxpayers cannot benefit from diverting income from personal services to an associated entity, to avoid the highest personal income tax rate on that income. However, in addition to that, as mentioned, the rule also prevents taxpayers from inappropriately reducing their child support or student loan repayment obligations, or reducing the income that is taken into account in determining Working for Families entitlements. Attributed income is added to any other income the working person derives, and feeds into the income amounts taken into account for child support, student loan and Working for Families purposes.

Reduction of beneficiary income if the attribution rule would result in the trust having a tax loss

77. There is a specific rule that applies where the entity is a trustee of a trust, and the amount attributable would cause the entity to have a tax loss for the year. If that is the case, beneficiary income from the trust for the year must be reduced – with the reduction divided among the beneficiaries (other than the working person). This ensures that a tax loss (which could be used in later years) cannot be generated for the trust by the distribution of amounts representing income attributed under the attribution rule. The rule is set out in s GB 29(6), which provides:

Reduction of beneficiary income when rule results in trust having tax loss

(6) If the associated entity is a trustee and the amount attributable would cause the associated entity to have a tax loss for the corresponding tax year, for the purposes of this Act,—

(a) beneficiary income from the trust for the income year must be reduced to the extent to which the associated entity's taxable income for the corresponding tax year is zero; and

(b) the reduction in beneficiary income must be divided among the beneficiaries other than the working person—

(i) according to proportions determined by the trust's trustees:

(ii) if the trustees do not make the determination, according to the proportion that each beneficiary's beneficiary income bears to the total beneficiary income from the trust for the income year.

78. This rule is beyond the scope of this Interpretation Statement, but is noted here for completeness.

Interaction between the attribution rule and the excessive remuneration rules

79. The final point to note is how the attribution rule interacts with the excess remuneration rules in ss GB 23 to GB 25B.

80. The excessive remuneration rules are specific anti-avoidance provisions that the Commissioner can invoke if she considers that:
    - excessive remuneration or income has been paid to a relative (s GB 23);
    - a partner's share of partnership profits or losses is excessive (s GB 23);
    - excessive remuneration has been paid by a close company to a shareholder or director, or a relative of a shareholder or director (s GB 25); or
    - excessive income is allocated under the LTC rules to a person aged under 20 who owns an effective look-through interest in an LTC, where a relative of the person also owns an effective look-through interest in the LTC (s GB 25B).

81. There are some exemptions to the rules, but generally in any of these situations the Commissioner can reallocate the income or losses based on what she thinks is reasonable.

82. If the remuneration is paid by a company, the excess is treated as a dividend. It cannot be deducted by the company (s DB 58). The effect of this is that the company's net income is increased by the amount of the excess remuneration. This results in a corresponding increase to the amount to be attributed under the attribution rule.

83. The overall effect of the way the excessive remuneration rules and the attribution rule work alongside each other is that the excess amount is taxed:
    - firstly, in the hands of the person who received the excessive remuneration, as a dividend; and
    - secondly, as income to the person it is attributed to under the attribution rule (s CE 8).

84. While this result may seem harsh, it is aimed at ensuring the correct levels of remuneration are paid and that taxpayers cannot structure their affairs in this way to split income and avoid higher personal tax rates (and gain the other advantages that may flow from splitting the income).

85. The excessive remuneration rules are discussed in more detail in QB 14/09 *Income Tax – Meaning of "excessive remuneration" and "excessive profits or losses" paid or allocated to relatives, partners, shareholders or directors*.

Appendix I – Legislation

Income Tax Act 2007

BC 2 Annual gross income

A person's **annual gross income** for a tax year is the total of their assessable income that is allocated to the corresponding income year.

BC 3 Annual total deduction

A person's **annual total deduction** for a tax year is the total of their deductions that are allocated to the corresponding income year.

BC 4 Net income and net loss

Income more than deductions

(1) If, for a tax year, a person's annual gross income is more than their annual total deduction, the difference is their net income for the year.

Income equal to deductions

(2) If, for a tax year, a person's annual gross income equals their annual total deduction, their net income for the year is zero.

…

BC 5 Taxable income

A person's **taxable income** for a tax year is determined by subtracting any available tax loss that the person has from their net income under Part I (Treatment of tax losses).

BD 1 Income, exempt income, excluded income, non-residents' foreign-sourced income, and assessable income

Amounts of income

(1) An amount is income of a person if it is their income under a provision in Part C (Income).

…

CE 8 Attributed income from personal services

When this section applies

(1) This section applies when, under sections GB 27 to GB 29 (which relate to the attribution rule), a person is required to attribute an amount to another person.

Income

(2) The amount attributed is income of the person to whom it is attributed.

Timing of income

(3) The amount is allocated to the income year in which it is attributed.

DC 8 Attribution of personal services

When this section applies

(1) This section applies when, under sections GB 27 to GB 29 (which relate to the attribution rule for income from personal services), an amount of income of a person (the associated entity) is attributed to another person (the working person).

Deduction

(2) The associated entity is allowed a deduction for the amount attributed.

Timing of deduction

(3) The deduction is allocated to the income year in which the amount is attributed to the working person.

Link with subpart DA

(4) This section supplements the general permission and overrides all the general limitations.

GB 27 Attribution rule for income from personal services

Application of section GB 29

(1) An amount of income in an income year of a person (the **associated entity**) is attributed to another person (the **working person**) under section GB 29 for the working person's corresponding tax year if,—

(a) during the income year, a third person (the buyer) acquires services from the associated entity, and the services are personally performed by the working person; and

(b) the working person is associated with the associated entity; and

(c) the threshold test in subsection (2) is met; and

(d) none of the exemptions in subsection (3) applies.

Threshold for application of attribution rule

(2) The attribution occurs only if—

(a) 80% or more of the associated entity's total income from personal services during the income year is derived from the supply of services to the buyer, a person associated with the buyer, or a combination of them; and

(b) 80% or more of the associated entity's income from personal services during the income year is derived through services personally performed by the working person, a relative of the working person, or a combination of them; and

(c) the working person's net income for the income year, assuming section GB 29 applies in relation to the associated entity and working person, is more than $70,000; and

(d) substantial business assets are not a necessary part of the business structure that is used to derive the total income referred to in paragraph (a).

Exemptions

(3) The attribution does not occur—

(a) if both the associated entity and the working person are non-residents at all times during the associated entity's income year:

(b) if the associated entity is a natural person and is neither a partner of a partnership nor a trustee of a trust:

(c) to the extent to which the services personally performed by the working person are essential support for a product supplied by the associated entity:

(d) if the total amount to be attributed to the working person, for the associated entity and the income year, is less than $5,000, unless—

(i) the application of this paragraph would prevent income being attributed to the working person for the income year in relation to another associated entity:

(ii) the associated entity is a CFC and a person who holds an attributing interest in the CFC files, after the date (the **Royal assent date**) on which the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 receives the Royal assent, a return of income in which the amount of income attributed to the working person is determined under this section:

(e) if the associated entity is a CFC and—

(i) the amount gives rise to attributed CFC income under section CQ 2(2B) (When attributed CFC income arises) or attributed CFC loss under section DN 2(2) (When attributed CFC loss arises) for a person who holds an attributing interest in the CFC; and

(ii) the person who holds the attributing interest in the CFC files, after the Royal assent date, a return of income in which the amount attributed to the working person is determined under section EX 20B (Attributable CFC amount).

Treatment of certain dividends

(4) If a company that is required to attribute an amount to the working person under this section and section GB 29 pays a dividend, sections HA 14 to HA 19 (which relate to qualifying companies) are treated as applying to the company and the dividend if—

(a) the dividend is paid—

(i) no earlier than the end of 6 months after the end of the income year referred to in subsection (1); and

(ii) from income that has been attributed to the working person under this section and section GB 29; and

(b) the company,—

(i) for each tax year that corresponds to an income year in which it derived income from which it pays the dividend, has no net income other than income attributed under this section and section GB 29, ignoring interest income that is incidental to the company's business; and

(ii) is not a qualifying company; and

(iii) chooses to have the dividend treated as if it were paid by a qualifying company; and

(iv) keeps sufficient records to enable the Commissioner to verify the matters referred to in paragraph (a).

Cancellation of notional imputation credits

(5) For the purposes of subsection (4), to the extent to which the dividend paid by the company would have had an imputation credit attached that arose under section OB 16 (ICA attribution for personal services) in the absence of the election made under subsection (4)(b)(iii), the credit is treated as cancelled immediately before it would have been attached under sections HA 14 to HA 19 (which relate to dividends paid by qualifying companies).

GB 28 Interpretation of terms used in section GB 27

When this section applies

(1) This section applies for the purposes of section GB 27.

Associated persons

(2) A person is treated as being associated with another person if they are associated at the time the services are personally performed by the working person.

Non-associated buyers

(3) For the purposes of section GB 27(2)(a), a buyer is not treated as being associated with another buyer if either—

(a) both buyers are public authorities; or

(b) the working person cannot be reasonably expected to know that a particular buyer is associated with another buyer, other than by making a specific enquiry.

Relatives

(4) For the purposes of section GB 27(2)(b), a person is a relative of the working person only if the person is a relative at the beginning of the relevant income year of the working person.

Fringe benefits included

(5) For the purposes of section GB 27(2)(c), the working person's annual gross income includes the taxable value of a fringe benefit, as determined under sections RD 25 to RD 63 (which relate to fringe benefit tax), provided or granted by a person associated with the working person.

Meaning of substantial business assets

(6) **Substantial business assets** means depreciable property that—

(a) at the end of the associated entity's corresponding income year, has a total cost of more than either—

(i) $75,000; or

(ii) 25% or more of the associated entity's total income from services for the income year; and

(b) is not for private use.

Assets subject to finance lease, hire purchase agreement, or specified lease

(7) For the purposes of subsection (6)(a), the cost of depreciable property includes—

(a) the consideration provided to the lessee in the case of property subject to a finance lease or a hire purchase agreement, including expenditure or loss incurred by the lessee in preparing and installing the finance lease asset for use, unless the lessee is allowed a deduction for the expenditure or loss, other than a deduction for an amount of depreciation loss:

(b) the cost price, in the case of property subject to a specified lease.

Private use of assets

(8) Subsection (6)(b) does not apply to depreciable property if 20% or less of the property's use is for private use.

Calculation of private proportion of use

(9) For the purposes of subsection (8), the percentage of a property's use for private purposes for an income year is calculated according to—

(a) the proportion that the number of days for which fringe benefit tax is payable by the associated entity in relation to the property bears to the total number of days in the income year in which the property is owned by or is subject to a finance lease, hire purchase agreement, or specified lease, involving the associated entity, if the property is subject to the FBT rules:

(b) the proportion that the expenditure incurred in relation to the property, for which a deduction is denied to the associated entity, bears to all expenditure incurred by the associated entity in relation to the property in the income year, if the property is not subject to the FBT rules.

GB 29 Attribution rule: calculation

Amount attributed

(1) A working person is treated as deriving income in an income year equal to the least of the following amounts:

(a) the associated entity's net income for the corresponding tax year, calculated as if their only income were derived from personal services:

(b) the associated entity's net income for the corresponding tax year:

(c) if and to the extent to which the associated entity is a company or a trust that has a loss balance to be carried forward under section IA 4 (Using loss balances carried forward to tax year) arising from a business or a trading activity of supplying personal services, the associated entity's net income for the corresponding tax year after subtracting the loss balance carried forward from an earlier corresponding tax year.

Associated entity's net income calculated before attribution

(1B) For the purposes of calculating the associated entity's net income for the corresponding tax year in the application of subsection (1), section DC 8 (Attribution of personal services) is ignored.

Calculation for trustee or partnership

(2) For the purposes of calculating the associated entity's net income for the corresponding tax year in the application of subsection (1),—

(a) if the associated entity is a trustee of a trust, the trustees are treated as not having made a distribution of beneficiary income out of the year's income:

(b) if the associated entity is a partnership, the associated entity is treated as a taxpayer and section HG 2 (Partnerships are transparent) does not apply:

(c) if the associated entity is a look-through company, the associated entity is treated as a taxpayer and section HB 1 (Look-through companies are transparent) does not apply.

Salary paid or fringe benefits treated as deductions

(3) For the purposes of calculating the associated entity's net income for the corresponding tax year in the application of subsection (1),—

(a) the associated entity is allowed a deduction for employment income paid to the working person during the income year:

(b) the associated entity is allowed a deduction for the taxable value of a fringe benefit provided or granted by the associated entity to the working person during the income year, and for the fringe benefit tax payable on the fringe benefit.

Reduction of attributable income for distributions

(4) For the purposes of calculating the associated entity's net income for the corresponding tax year in the application of subsection (1), the amount of net income of the associated entity for the corresponding tax year is reduced by—

(a) in the case of a trustee of a trust, the amount of beneficiary income derived by the working person from the trust in the income year:

(b) in the case of a partnership, the share of profits allocated by the partnership to the working person:

(c) in the case of a company, a dividend paid—

(i) by the associated entity to the working person during the income year or before the end of 6 months after the end of the income year; and

(ii) from income derived in the income year.

Attribution reduced by market value of administrative services

(5) If the associated entity is a partnership that receives administrative services from another person related to their income from personal services and has not paid for the administrative services, the amount to be attributed to the working person is reduced by the market value of the administrative services provided by the other person.

Reduction of beneficiary income when rule results in trust having tax loss

(6) If the associated entity is a trustee and the amount attributable would cause the associated entity to have a tax loss for the corresponding tax year, for the purposes of this Act,—

(a) beneficiary income from the trust for the income year must be reduced to the extent to which the associated entity's taxable income for the corresponding tax year is zero; and

(b) the reduction in beneficiary income must be divided among the beneficiaries other than the working person—

(i) according to proportions determined by the trust's trustees:

(ii) if the trustees do not make the determination, according to the proportion that each beneficiary's beneficiary income bears to the total beneficiary income from the trust for the income year.

Attribution to more than 1 working person

(7) If the amount attributable is to be attributed to more than 1 working person, the share attributed to each working person must reflect the respective value of the services personally performed by each working person.

LJ 2 Tax credits for foreign income tax

Amount of credit

(1) A person described in section LJ 1(2)(a) has a tax credit for a tax year for an amount of foreign income tax paid on a segment of foreign-sourced income, determined as if the segment were the net income of the person for the tax year. The amount of the New Zealand tax payable is calculated under section LJ 5.

…

When subsections (9) and (10) apply

(8) Subsections (9) and (10) apply when a person (the associated entity) resident in New Zealand derives an amount (the attributed amount) that—

(a) is assessable income of the associated entity that is sourced from outside New Zealand; and

(b) is attributed under sections GB 27 to GB 29 (which relate to the attribution rule for income from personal services) in an income year to another person (the working person) who is resident in New Zealand when the associated entity derives the attributed amount.

Tax credit: attributed income from personal services

(9) Despite section LJ 1(2)(a), the working person has a tax credit under this subpart for foreign income tax paid on the attributed amount by the associated entity or withheld in relation to the attributed amount. The calculation of the maximum amount of the tax credit is made under section LJ 5(2), modified so that the item segment in the formula is the attributed amount for the income year.

No tax credit for associated entity

(10) The associated entity does not have a tax credit under this subpart for foreign income tax paid on or withheld in relation to the attributed amount.

References

Legislative references

Income Tax Act 2007

Sections BC 2, BC 3, BC 4, BD 1, BD 2, BD 3, BD 4, CB 6, CE 8, DB 58, DC 8, DG 15 to DG 19, EL 4, EL 20, GB 23, GB 25, GB 25B, GB 27 to GB 29, HA 14(2), HA 15(4), HG 2 to HG 12, IA 4, IC 5, LJ 2, OB 16, and OB 40, Subparts EL and HB, and Part I

Other references

QB 14/09 *Income Tax – Meaning of "excessive remuneration" and "excessive profits or losses" paid or allocated to relatives, partners, shareholders or directors* (Inland Revenue)

IS 19/02 *Income tax – attribution rule for income from personal services* (Inland Revenue)

STANDARD PRACTICE STATEMENTS

These statements describe how the Commissioner will, in practice, exercise a discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

SPS 21/01: Deduction notices

Application

The Statement applies from the date of signing. It replaces SPS 11/04 Compulsory deductions from bank accounts, which was published in Tax Information Bulletin, Vol 23, No 5 (June 2011).

The Statement outlines the Commissioner's powers to require deductions from amounts that are payable, or will be payable to, a taxpayer who has arrears. It applies to deduction notices issued under the following enactments:

- The Tax Administration Act 1994 ("the TAA")
- Child Support Act 1991 ("the CSA")
- Gaming Duties Act 1971("the GDA")
- Goods and Services Tax Act 1985 ("the GSTA")
- Student Loan Scheme Act 2011 ("the SLSA")

Standard practice

Summary

1. A deduction notice is an important debt collection tool for the Commissioner. The relevant legislative provisions grant the Commissioner the power to require a third party to make deductions from amounts that are payable, or will become payable by that third party, to a taxpayer who has a tax liability.[1]
2. A deduction notice may require deductions to be made by the way of lump sum or by instalments. A deduction notice will continue to apply until a deduction is made in respect of a notice requiring deduction by lump sum, or in respect to an on-going notice, until the amount required pursuant to the notice has been deducted or the notice is either revoked or withdrawn by the Commissioner.
3. Deductions made by the person are held in trust for the Crown until they are forwarded to the Commissioner. If the deduction is not made by the person, the amount required to be deducted may be recoverable by the Commissioner from the person as if it were tax payable by that person (in respect of deduction notices issued for child support banks are excluded from being liable if they fail to deduct, all other persons will be liable). The Commissioner also has the power to prosecute a person for not complying with the terms of a deduction notice under s 157A.

Detailed discussion

4. Taxpayers who are liable to pay an amount of tax to the Commissioner will have due dates for payment of those amounts. Where a due date for payment is not met, a taxpayer will have an amount that is due and payable to the Commissioner. Where there is an amount owing to the Commissioner by a taxpayer, she may take action to recover that outstanding amount. One action available to her is to require an employer, bank or other third party who is liable to pay an amount to the taxpayer to pay that amount to the Commissioner instead. This is done by sending a deduction notice to the third party requiring the third party to pay all or some of the amount due to the Commissioner instead of to the taxpayer.
5. The decision to take any debt collection action, including the use of a deduction notice, is made only after consideration of all relevant information, including any previous communication between the IR and the taxpayer, the amount and the age of the arrears and any known hardship or hardship likely to be experienced by the taxpayer.[2]

[1] Tax Liability here includes core tax, late filing penalties, late payment penalties, use of money interest, shortfall penalties and amounts under the Child Support Act 2011.

[2] See standard practice statements SPS 18/04 *Options for relief from tax debt; SPS 11/02 Child support debt – Requesting an instalment arrangement*; and SPS 11/03 *Student loans – Relief from repayment obligations.*

6. Prior to issuing a deduction notice, the Commissioner will typically, notify the taxpayer of an upcoming tax liability, advise that the amount is past due and issue a final warning letter. In many cases we will attempt to telephone the taxpayer before a final warning letter will be issued. The Commissioner views the issuing of a deduction notice as a last resort in most cases.
7. As a result of a major upgrade made to Inland Revenues systems over the past few years, the Commissioner has more information, from a wider variety of sources often in real time. This will allow the Commissioner to be more proactive to prevent many more taxpayers falling into situations where they will have tax to pay. This allows for an increased accuracy in the information held and for more effective communications with taxpayers.
8. A compulsory deduction notice cannot be disputed by either the taxpayer or the third party through the disputes process under Part 4A of the TAA. Further, a compulsory deduction notice cannot be challenged under Part 8 of the TAA.[3]

Situations where a deduction notice will not be issued

9. A compulsory deduction notice will not be issued in the following circumstances:
   - 9.1 Where a taxpayer has a tax liability and is keeping to an instalment arrangement.
   - 9.2 Where the taxpayer or the Commissioner has initiated the disputes process under Part 4A of the TAA for period(s) under dispute.
   - 9.3 Where a taxpayer is challenging an assessment through the Courts and the tax is deferred. Tax is deferred after the taxpayer files a Statement of Claim / Notice of Claim with the Court.

Tax liability

10. A deduction notice can be issued when the taxpayer has an overdue tax liability. The Commissioner will not issue a deduction notice for tax arrears that are subject to an instalment arrangement between the taxpayer and the Commissioner, so long as the arrangement is being adhered to by the taxpayer.
11. Where the tax liability is in the name of the taxpayer, then an amount payable to that taxpayer which they are entitled to receive in their personal capacity may be subject to a deduction notice.
12. In some cases, a taxpayer may be liable for a tax liability that is recorded in the name of another taxpayer. For example, trustees of a trust are jointly and severally liable for the income tax liabilities of the trust.[4] This means that the Commissioner can recover an income tax liability of the trust from a trustee and may issue a deduction notice against amounts payable to the trustee in their personal capacity.
13. Similarly, an agent may be liable for the tax liability or arrears of another taxpayer[5] so that a deduction notice may be placed on an amount payable to the agent in order to satisfy the liability of the principal taxpayer.
14. In respect of a Working for Families tax credit debt, s MF 5(2) of the Income Tax Act 2007 ("ITA'07") provides that both the primary caregiver and their partner or spouse throughout the income year to which the overpayment relates, are jointly and severally liable for any overpayment of Working for Families tax credits. The Commissioner may place a deduction notice on the bank accounts of the primary caregiver and/or their spouse for the income year, and any joint account held in the names of the parties.
15. In respect of GST it is noted that s 43 of the GSTA only applies to amounts payable to the "registered person" and will not apply to amounts payable to a person who is jointly liable for (e.g. a partner in a partnership or trustee in respect of a trust)[6], or is an agent in respect of (e.g. an agent carrying on the taxable activity of an absentee)[7], the registered person's GST liability.

Daily interest

16. A deduction notice may require deductions to be made to cover daily interest accruing on the tax liability. The interest starts on the date of the deduction notice and ends on the day on which the amount is required to be deducted, has been deducted. If interest is to be calculated, the rate of interest will be advised in the deduction notice.

[3] Section 138E(1)(e)(iv) of the TAA.

[4] Section HC 2 of the ITA'07. See also *C of IR v Newmarket Trustees Ltd* [2012] NZCA 351; (2012) 25 NZTC 20-139; and *Dorchester Finance Ltd v Ngahuia Ltd* (2010) 3 NZTR 20-001.

[5] See ss HD 2 and HD 3 of the ITA'07.

[6] Section 27(3) of the GSTA.

[7] Section 59(2) of the GSTA.

Amount payable

17. A deduction notice requires a third party to pay an amount to the Commissioner rather than to the person to whom the amount is payable. What is an amount payable to the person is discussed below.

To the person

18. A deduction notice may be issued to a third party and applied against any money payable by that third party to the taxpayer. It does not matter whether the third party is paying the money to the taxpayer on their own account or as an agent for somebody else. It also does not matter if the taxpayer has appointed an agent as the recipient of the amount.[8] Accordingly, any amount payable by a third party (or their agent) to a taxpayer (or their agent) will be subject to a deduction notice issued by the Commissioner.

Amounts payable by a person on a joint account

19. A deduction notice may be placed on joint accounts when the money is able to be withdrawn from that account by the defaulting person without the signature or other authorisation of the other joint account holder(s). Note that a deduction notice can only be placed on a partnership account in respect of the partnership's liability as a taxpayer under the relevant act. A deduction notice cannot be placed on a partnership bank account to satisfy a partner's personal tax liability.
20. A deduction notice will apply to money that is held in a term investment, whether or not that investment is due to mature.

Foreign currency

21. The balance of an account denominated in a foreign currency may be the subject of a deduction notice despite the currency of the account. The balance of the account would represent an amount payable to the taxpayer in question even though not payable in New Zealand dollars.

One-off and on-going deductions

22. A deduction notice may require deductions to be made either in a lump sum (one-off notice) or by instalments (on-going notice). The manner of the deduction will be specified in the notice.
23. A deduction notice will continue to apply until a deduction is made by the third party in respect of a one-off notice requiring deduction by lump sum, or in respect to an on-going notice, until the amount required pursuant to the notice has been deducted or the notice is either revoked or withdrawn by the Commissioner.
24. If a deduction notice requires multiple deductions over a period of time, then the amounts due do not need to be adjusted each pay period, unless there is a low pay period and the limitation in s 157(3) applies as set out below at [26] to [27].
25. Note that an attachment order issued by the Court is not covered by this Statement.

Limits that can be deducted from salary and wages

26. Deduction notices issued against a taxpayer's salary and wages have limits as to the amount that may be deducted. In respect of deduction notices for all but liabilities due under the CSA, the amount the Commissioner may require an employer to deduct is limited to the greater of:
    - The lesser of 10 percent of the tax liability per week; or
    - 20 percent of the gross salary or wages payable to the taxpayer on each pay day; or
    - $10 per week.
27. Please also take note of the following:
    - 27.1 If the taxpayer is not paid weekly, multiply the instalment amounts to suit the pay period.
    - 27.2 If the deduction amount is less than $10 per week, the amount to deduct is $10 per week.
    - 27.3 If the taxpayer earns less than $10 per week, the third party is not required to make an extra deduction.
    - 27.4 If the taxpayer asks the third party to deduct an extra amount, then the third party must do this.
28. These limits ensure a taxpayer does not have their entire salary or wage taken by the Commissioner (unless they receive a payment of $10 or less as a salary or wage).

[8] *Gennaker Holdings v IRD* (1991) 13 NZTC 8,154; (1991) 16 TRNZ 193.

Example 1

Kerry has an outstanding tax liability and has refused to make an arrangement with the Commissioner for the payment of that debt. Kerry's debt is $3,000 and the Commissioner's records show that Kerry has commenced receiving a weekly wage from an employer. A deduction notice is issued to Kerry's employer requiring a deduction of the lesser of $300 (being 10% of the tax debt) or 20% of Kerry's wage.

Kerry is paid $900 on each pay day and their employer withholds $180 (being 20% of the wage paid to Kerry).

Note – the same amount would be required to be deducted if the tax liability was for either of GST, gaming duty or student loan payments.

29. The CSA has priority over any attachment order issued by the Courts or deduction notice issued under any other Act (including the other Inland Revenue Acts).[9] Furthermore, a deduction for financial support due under the CSA may require an employer to deduct up to 40% of the net payment under the PAYE rules of the ITA'07.[10]

30. A s 154 (CSA) deduction notice for a child support debt will always take priority over a s 157 (TAA) notice for other tax types. This ensures that the taxpayer will always receive at least 60% of the net payment (i.e. payment due after PAYE is withheld) due from their employer. The debt for other tax types will be dealt with separately.

Example 2

Deduction notice for financial support

Michael has an outstanding financial support liability and has refused to make an arrangement with the Commissioner for the payment of the debt. The outstanding financial support is $3,000 when the Commissioner's records show Michael has commenced receiving a wage from an employer. A deduction notice is issued to Michael's employer requiring a deduction of the lesser of $3,000 or 40% of Michael's wage after PAYE is deducted.

Michael is paid $800 (net of PAYE) and his employer withholds $320 (being 40% of Michael's wage (net of PAYE)).

Copy of deduction notice to be sent to the taxpayer

31. The Commissioner will send a copy of the deduction notice to the taxpayer. Where the taxpayer does not have a valid address, a deduction notice may be sent to the taxpayer's last known address, unless the third party to whom the deduction notice is sent is the current employer of the taxpayer. In that case no copy of the notice needs to be sent.

32. Alternatively, the Commissioner may dispense with the requirement to send a copy of a deduction notice to a taxpayer altogether where the Commissioner has, or can find, no valid address for the taxpayer or their employer.

Revoking a deduction notice

33. The Commissioner may cancel a deduction notice by notifying the third party to not make the deduction or to make a deduction for a different amount. If the taxpayer has paid their tax liability or has agreed to an arrangement with the Commissioner for the payment of their tax liability, the Commissioner will notify the third party in writing that the deduction notice is cancelled.

Withheld amounts

34. Once the third party has withheld an amount pursuant to a deduction notice they hold that amount on trust for the Crown and must make payment of the amount to the Commissioner in the time provided for in the deduction notice. If the third party fails to pay the withheld amount, then they will be liable to pay use of money interest on this amount.

35. If a third party fails to pay the Commissioner an amount they have deducted, the third party will be liable for that amount plus use of money interest. Further, the Commissioner may take action to recover that amount from that third party. The third party may also be liable for criminal penalties for failing to account for the withheld amount.

36. On making a deduction the third party must notify the taxpayer of the fact of the deduction or extraction and of the purpose for which it was made.

37. A person who makes a deduction required under a deduction notice is deemed to be acting under the authority of the taxpayer to whom the notice relates and is indemnified in respect of the deduction made.

[9] Section 154 of the CSA.

[10] Refer to the IR335 *Employer's Guide: Information to help you with your responsibilities as an employer*. Also refer to s 165 of the CSA.

Failure to comply with a deduction notice

38. If a third party fails to make a deduction as required, the Commissioner may take recovery action against that third party for failing to deduct and pay the Commissioner in accordance with the deduction notice.
39. This ability to recover amounts not withheld applies to all tax liabilities except deductions of financial support required to made by a bank under s 154 of the CSA, in which case the bank will not be liable for financial support it fails to deduct.[11]
40. Where the Commissioner recovers an amount from a third party who had failed to make a deduction required by a deduction notice issued to them, that third party may, in turn, seek to recover that amount from the taxpayer.
41. As well as being liable for the amounts that were not deducted, a third party may also be prosecuted for failing to deduct an amount and may be fined or imprisoned.

This Standard Practice Statement is signed on 12 April 2021.

Rob Falk
National Advisor
Technical Standards, Legal Services

Legislative references

The relevant sections which grant the Commissioner the power to issue a deduction notice are as follows:

- Section 157 of the TAA
- Section 151(2) of the CSA
- Section 154 of the CSA
- Section 12L of the GDA
- Section 43 of the GSTA
- Section 193 of the SLSA

[11] Section 168(2) of the CSA.

REVENUE ALERTS

Provides information about a significant and/or emerging tax planning issue that is of concern to Inland Revenue.

RA 21/01: Diverting personal services income by structuring revenue earning activities through a related entity such as a trading trust or a company: the circumstances when Inland Revenue will consider this arrangement is tax avoidance

About Revenue Alerts

A Revenue Alert is issued by the Commissioner of Inland Revenue and provides information about a significant and/or emerging tax planning issue that is of concern to Inland Revenue. At the time an alert is issued risk assessments will already be underway to determine the level of risk and to consider appropriate responses.

A Revenue Alert will identify:

- the issue (which may be a scheme, arrangement, or particular transaction) which the Commissioner believes may be contrary to the law or is inconsistent with policy;
- the common features of the issue;
- our current view; and
- our current approach.

An alert should not be interpreted as being Inland Revenue's final position. Rather, an alert outlines the Commissioner's current view on how the law should be applied. For any alert we issue it is likely that some investigatory work has already been carried out.

If people have entered into an arrangement similar to the one described or are thinking about it, they should talk to their tax advisor for advice about tax implications and/or to Inland Revenue.

Background

There may be legitimate reasons for using entities such as trusts or companies in many business situations. The mere use of alternative business structures will not, on its own, amount to a tax avoidance arrangement. Further, the profit generated by the business may not be wholly generated by the individual and there may also be good non-tax reasons as to why the controller of a business receives significantly less of the business' profits than would otherwise be the case.

However, where the business involves the provision of personal services, Inland Revenue is likely to examine closely any arrangement where the individual service provider (usually the real owner or controller of the business) is not receiving a significant portion of the profits derived from the business. This is particularly so where there is an absence of other business profit drivers and other non-tax reasons do not justify the level of remuneration received by the individual.

Inland Revenue's position in this regard was confirmed by the Supreme Court's 2011 judgment in *Penny and Hooper*. That decision confirms that income substantially generated by the direct personal skills, experience or labour of an individual should generally be subject to tax in the hands of that individual. The individual's contribution to the business should be properly reflected in the income returned by that individual - either through an appropriate salary or other taxable distributions to the individual.

Inland Revenue will closely examine situations where an arrangement has the effect of diverting income earned from the personal exertion of an individual but the benefit of those diverted funds is still enjoyed, directly or indirectly, by the individual or their family or associates. The focus will generally be on the most serious and artificial cases - where the arrangement results in a substantial proportion of the income generated by the business being diverted away from the individual service providers.

In many cases, taxpayers entering into these types of arrangements are also benefiting from reduced child support liabilities or student loan repayment obligations. In some cases, taxpayers are structuring their remuneration at a level that will allow them access (or greater access) to other non-income tax benefits that rely on income calculated for tax purposes.

Features

It is often a combination of factors, such as those listed below, that is of concern. Where income is generated from the supply of services provided by an individual, a combination of some or all of the following factors may result in a close look at a business structure:

1. The controller of the business arranges for an entity, such as a trading trust or company, to operate and own the business. The operating entity engages or employs the individual (or contracts for their services);
2. The business may not in substance be operated according to the terms of the arrangements entered into. This will involve examining the agreements themselves, the manner in which they are actually implemented and also whether the overall arrangement is commercial having regard to a comparison with relevant standard business practices;
3. The degree to which the individual or their family ultimately controls the entity, its economic product and cash flows from the business;
4. Whether there is a redistribution of the underlying income from the entity to the individual or to family members. This is usually via a trust but there are other mechanisms, for example, by way of employment of the family members perhaps at inflated salaries, or related party loans, or the payment of management and other service fees to associates; and
5. The extent to which, as a consequence of the arrangement, significant tax benefits are obtained e.g. where the entity and/or any beneficiaries or shareholders pay lower marginal tax rates than would have been payable by the individual, but for the arrangement.

Some arrangements may involve a restructure of an existing business. This statement will apply equally to those businesses which have been operating since commencement in a trust or company. A further factor which will be considered in a restructure is whether the business operates substantially as it did before its transfer to the related entity.

In certain circumstances, notwithstanding that all or most of the above factors may be present, the arrangement may not constitute tax avoidance. This may be because there are legitimate reasons for adopting particular business structures (such as asset protection, limited liability and business continuity). Businesses can also legitimately make decisions about whether or not, or the extent to which, profits are to be retained or distributed.

There is also nothing preventing an individual, or entities related to the individual, from owning the business and receiving distributions of profit reflecting that ownership. Further, it may be appropriate in certain circumstances for family members or related entities to receive funds from the business as:

- An employee or service provider; and/or
- An owner of capital equipment used by the business.

However, in those circumstances care needs to be taken that the relevant transactions can be commercially justified. The Commissioner will be more concerned with arrangements that have non arms-length factors present, especially where the individual service provider is not adequately remunerated for their contribution to the business. The focus will be to look at the totality of the arrangements.

Businesses need to have a valid commercial basis for the way in which profits are distributed, especially in the form of remuneration paid to individuals they employ or contract to provide services. The profits of a business will generally be driven by a combination of the following:

- *The controllers of the business' personal skill, judgement and exertion*: The more specialised and marketable those attributes are, the greater the remuneration should be;
- *The use of capital assets*: Where the business and not the individual owns significant assets that are used to generate business income, the owners of the business are entitled to an appropriate return on those assets;
- *Services provided by other staff*: Similarly, where the business employs other skilled staff, some of the business income generated can be seen as contributing to the business' profits and not the individual business controllers. The greater the number of specialist staff employed in the business, the more influential this will be;
- *Intangible assets*: Sometimes the profits of a business may also be improved through matters such as business know-how or other IP owned by the business. As with capital assets, an appropriate return on such assets can be expected by the business; and
- *Return on business risks*: This may be influenced by factors such as who has legal liability for the business or its funding. For example, who carries the reputational risk for the business, who is liable to the industry body for any wrongdoing, what insurance policies are in place, and who guarantees any borrowings. Where the business structure does little to remove those risks from the individual business controller, the individual's overall remuneration should reflect those risks.

It is recognised that it can sometimes be difficult to determine an appropriate remuneration for the individual. There is no exact science to weighing up the extent to which the individual is responsible for the business' profit (instead of other profit drivers). However, in most circumstances, the main profit driver of a service business will be the personal skills and exertions of the controller of the business - particularly where the business does not require a great deal of capital.

In those circumstances, it is expected that the compensation received by that individual (whether by way of salary, service fees, distributions of profits or any combination of them) will be significantly more than the return received by entities associated with the business. That will be weighed against what happens to other forms of distribution from the business received by the related entities (such as loans, dividends, salaries, service fees, trust distributions etc).

Given our focus on the more artificial arrangements, and the resources available to us, we are more likely to examine arrangements where the total remuneration and profit distributions received by the individual service provider (and controller of the business) is less than 80% of the total distributions received by that individual, their family and related entities. However, this should not be relied on as a safe harbour as neither the legislation nor the Supreme Court prescribed a minimum percentage to distribute, and Inland Revenue will apply the matters discussed in the *Penny and Hooper* judgment when reviewing taxpayer arrangements.

Inland Revenue's approach focuses on the commercial reality of the business, and not on "market" salaries, or comparable industry averages. There may be particular reasons as to why an individual business controller may not be adequately remunerated in a particular year. Examples of this include:

- Adverse business conditions mean that the business' profits are down but most of those profits are still paid out to the individual service providers;
- It is financially prudent to retain some profits in the business because it is anticipated that the business may experience financial difficulties in the near future;
- The profits are set aside to acquire business assets in the next financial year; or
- The business relates to a charity and the individual receives less to ensure the charity's return is maximised.

There may be other non-tax reasons why a business may pay the individual less than an arms-length party would receive over the short-term. However, in those circumstances, we would accordingly expect to see no significant distributions being made to entities associated with the individual.

Current view: diverting personal services income

Inland Revenue considers that arrangements that exhibit a combination of the above features may constitute an avoidance arrangement in terms of ss BG 1 or GB 44 of the Income Tax Act 2007. Such cases fall outside the contemplation of Parliament.

To determine whether or not there has been tax avoidance, Inland Revenue will look at all aspects of these arrangements, including all documentation, and the actual behaviours of the persons involved.

In summary, whether or not the arrangement under consideration is a tax avoidance arrangement in relation to the tax payable on the entity's distributed profits in any given income year will depend on an examination of:

- The reality of the business' structure and how it operates commercially;
- Whether and how the profits of the business have been distributed in substance - including whether the individual and their family continue to receive the benefit of all profit distributions from the business;
- Whether the remuneration received by the individual service provider appropriately reflects the individual's contribution to the business' profit; and
- Whether there are particular non-tax reasons justifying a departure from that standard.

Options available to Inland Revenue on reconstruction include deeming all of the income to have been derived by the individual (in appropriate circumstances) or deeming that individual to have received some other amount of remuneration personally (e.g. an amount that more properly reflects the individual's contribution to the business' profits).

Inland Revenue has investigated a number of these arrangements over the years. Where we still consider, after initiating the tax disputes process, that the arrangement is tax avoidance, amended assessments will be issued which attribute some or all of the diverted income to the taxpayer, to counteract the tax benefit resulting from the use of this arrangement.

With the introduction of the increased top marginal tax rate, Inland Revenue will monitor behaviours and continue to investigate similar arrangements where there are significant tax benefits, considering both the business structures utilised and the annual decisions made around remuneration levels. Many other arrangements involving service providers share some features of the arrangements considered in *Penny and Hooper* but have their own particular characteristics. Those factors will be taken into account in any investigation, but this Revenue Alert seeks to highlight the general issues we consider relevant to such arrangements. Where the tax avoidance rules apply, steps will be taken to counteract the tax benefits obtained.

Late payment penalties and use of money interest may be applied to taxpayers who enter into the type of arrangement described in this Revenue Alert.

Shortfall penalties may also apply, although these may be reduced where a voluntary disclosure is made.

Inland Revenue would also consider imposing promoter penalties in appropriate circumstances.

If you consider that the concerns outlined in this Revenue Alert may apply to your situation, we recommend you discuss the matter with your tax advisor or with Inland Revenue and consider making a voluntary disclosure.

Authorised by Karen Whitiskie on 29 March 2021

References to consider

The following related references will assist taxpayers with determining whether their arrangement is subject to the avoidance provisions in the Revenue Acts.

Subject references:	Tax avoidance
Legislative references:	BG 1 ITA 2007 GA 1 ITA 2007 GB 1 ITA 2007 GB 22 ITA 2007 GB 23 – 25B ITA 2007 GB 27 – 29 ITA 2007 GB 31-32 ITA 2007 GB 44 ITA 2007
Interpretation statements:	IS 13/01 – Tax Avoidance and the interpretation of sections BG 1 and GA 1 of the Income Tax Act 2007 IS 18/02 – Taxation of trusts – income tax IS 19/02 – Income tax – attribution rule for income from personal services IS 21/02 - Income tax – calculating income from personal services to be attributed to the working person
Standard practice statements:	SPS 19/02 Voluntary Disclosures (see also booklet IR281)
Questions we've been asked:	QB 14/09 – Meaning of 'excessive remuneration' and 'excessive profits or losses' paid or allocated to relatives, partners, shareholders or directors
Revenue Alerts items:	RA 08/01 RA 10/01 RA 11/02 RA 18/01 – Dividend stripping – some share sales where proceeds are at a high risk of being treated as a dividend for income tax purposes RA 18/01a – Questions and answers
Case Law:	*Beacham v CIR* [2014] NZHC 2839, (2014) 26 NZTC 21,111 *John George Russell v CIR* [2012] NZCA 128, (2012) NZTC 20,120 *Penny and Hooper v CIR* [2011] NZSC 95, [2012] 1 NZLR 433, (2011) 25 NZTC 20,073 *Ben Nevis Forestry Ventures Limited v CIR* [2008] NZSC 115, [2009] 2 NZLR 289

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REGULAR CONTRIBUTORS TO THE TIB

Tax Counsel Office

The Tax Counsel Office (TCO) produces a number of statements and rulings, such as interpretation statements, binding public rulings and determinations, aimed at explaining how tax law affects taxpayers and their agents. The TCO also contributes to the "Questions we've been asked" and "Your opportunity to comment" sections where taxpayers and their agents can comment on proposed statements and rulings.

Legal Services

Legal Services manages all disputed tax litigation and associated challenges to Inland Revenue's investigative and assessment process including declaratory judgment and judicial review litigation. They contribute the legal decisions and case notes on recent tax decisions made by the Taxation Review Authority and the courts.

Technical Standards

Technical Standards sits within Legal Services and contributes the standard practice statements which describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical operational issues arising out of the administration of the Inland Revenue Acts. They also produce determinations on standard costs and amortisation or depreciation rates for fixed life property used to produce income, as well as other statements on operational practice related to topical tax matters. Technical Standards also contributes to the "Your opportunity to comment" section.

Policy and Regulatory Stewardship

Policy advises the Government on all aspects of tax policy and on social policy measures that interact with the tax system. They contribute information about new legislation and policy issues as well as Orders in Council.

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