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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.

IN SUMMARY

Order in Council

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This question we've been asked explains the application of the resident withholding tax and non-resident withholding tax rules to situations where negative interest is charged on an advance of money or a loan.

QB 21/03: Charities business exemption – business carried on in partnership 19

This question we've been asked considers whether income derived by a charitable entity from a business will be exempt under s CW 42 if the business is carried on by a charitable entity in partnership with a non-charitable entity.

Standard practice statement

SPS 21/02: Retention of business records in electronic formats, application to store records offshore and keeping records in languages other than English or te reo Māori 22

This statement provides guidelines on the retention of business records in electronic format and sets out the Commissioner's practice when considering an application to store business records offshore and when considering an application to keep records in a language other than English or te reo Māori.

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This is a judicial review proceeding in which Mr Lindsay challenged the Commissioner of Inland Revenue's ("the Commissioner") decision requiring him to pay child support dating back to 2003.

Cooke J upheld Mr Lindsay's judicial review challenge, making a declaration that the child support assessment of the Commissioner dated 23 November 2017 is invalid to the extent that it imposed backdated liability to 2003.

Cooke J also awarded scale costs against the Commissioner with an uplift of 10%.

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: Income Tax (Employment Income—Meaning of Accommodation) Regulations 2021

An Order in Council was made on 19 April 2021 to establish a tax exemption for accommodation that is provided to enable employees to isolate due to the risk of the spreading COVID-19.

Background

The starting position under the employment income rules is that the value of accommodation provided to a person in relation to their employment is employment income and subject to tax. This is because it is in effect an alternative to the person receiving more salary or wages, which would normally be taxed. The Income Tax Act 2007 includes some targeted exclusions to this general rule, and also provides that regulations may be made to create further exclusions.

Key features

The eligibility criteria for the exclusion established by these new regulations are that where the accommodation is provided, it is:

- to enable an employee to isolate due to the risk of the outbreak or spread of COVID-19
- not normally provided as part of the employee's remuneration package for their role or for a similar role
- not provided in substitution for a greater amount of employment income
- provided for a period of three months or less, and
- provided between 22 April 2021 and 30 June 2022.

Accommodation meeting the criteria will not be included as income of the employee because the private benefit is incidental to the business purpose of providing the accommodation. Expenditure of the employer to provide this accommodation will continue to be deductible under the standard rules.

Example 1: International flight crew

Accommodation is provided to aircrew so that they can isolate from the community for 48 hours on arrival in New Zealand due to the risk of spreading COVID-19. The value of this accommodation is not treated as employment income under the new exclusion.

Example 2: Front-line health workers

Accommodation is provided to a front-line health worker for four weeks so that they can isolate from a member of their household who is at risk of severe illness from COVID-19. The value of this accommodation is not treated as employment income under the new exclusion.

Example 3: Harvest workers

Accommodation is provided to harvest workers so that they can isolate in separate team bubbles during a two-week lockdown, to manage the risk of COVID-19 spreading through the workforce during the harvest window. The value of this accommodation is not treated as employment income under the new exclusion.

Application date

The regulations came into force on 22 April 2021 and will apply to accommodation which meets the eligibility criteria and is provided between that date and 30 June 2022.

BINDING RULINGS

This section of the *TIB* contains binding rulings that the Commissioner of Inland Revenue has issued recently. The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates their tax liability based on it.

For full details of how binding rulings work, see *Binding rulings: How to get certainty on the tax position of your transaction (IR715)*. You can download this publication free from our website at **www.ird.govt.nz**

Product Ruling – BR Prd 21/02: Fonterra Co-operative Group Limited

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

Name of person who applied for the Ruling

This Ruling has been applied for by Fonterra Co-operative Group Limited (Fonterra).

Taxation Laws

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

This Ruling applies in respect of ss BG 1, CD 4, CD 5, CD 6, CX 56, CX 56B, DA 1, DB 23, subpart HM, and the definition of "foreign investment variable-rate PIE" in s YA 1.

The Arrangement to which this Ruling applies

The Arrangement is the establishment and operation of the Fonterra Shareholders' Fund (FSF). The FSF is a New Zealand–resident unit trust through which non–milk-supplying investors (Public Investors) and farmers supplying milk to Fonterra (Supplying Shareholders) can invest in Units. Units in the FSF give Public Investors and Supplying Shareholders economic rights in Fonterra shares (Shares), but do not give them any legal interest in the Shares.

Units in the FSF are issued when a Supplying Shareholder, registered volume provider (RVP) (whose Shares are held in the name of the Custodian on trust for the RVP), or Fonterra transfers the legal ownership of Shares to Fonterra Farmer Custodian Limited (Custodian). The Custodian holds the economic rights in those Shares on trust for The New Zealand Guardian Trust Company Limited as trustee of the FSF (Supervisor).

The FSF was established in November 2012. Trading in FSF Units commenced on the NZX Main Board on 30 November 2012. A total of 95,454,545 Units were on issue at that date, for a total consideration of $525 million.

Further details of the Arrangement are set out in the paragraphs below.

Parties to the Arrangement

1) The parties to the Arrangement are:
    a) Fonterra,
    b) the FSF (through the Manager or Supervisor),
    c) Donald Hammond, Donna Smit and Ian Brown in their capacity as trustees of the Fonterra Farmer Custodian Trust (Farmer Trustees),
    d) the Custodian,
    e) the Supervisor,
    f) FSF Management Company Limited as manager of the FSF (Manager),
    g) Supplying Shareholders,
    h) RVPs, and
    i) Public Investors.

2) Supplying Shareholders, RVPs, Farmer Trustees, Fonterra and Public Investors may invest in the FSF. Together, they are referred to as the Unit Holders.

3) The Farmer Trustees hold one Unit in the FSF (the Fonterra Unit) which has special, essentially veto, rights (cls 4.5 to 4.8 of the Trust Deed). These special rights mean the Farmer Trustees must approve, for example, an amendment to, removal of or alteration of a provision in the Trust Deed where that amendment, removal or alteration would change the:

   a) governance structure of the board of the Manager,

   b) scope and role of the trust fund,

   c) obligation of the trust to facilitate the exchange of a Share for a Unit or a Unit for a Share, or

   d) 15% limit on the number of Units that any person or their associated persons (other than Fonterra or a wholly-owned subsidiary of Fonterra) can hold, or

   e) terms of the Fonterra Unit.

4) The rights of the Fonterra Unit to proceeds and distributions from the FSF are the same as for all other Units (cl 4.5(h) of the Trust Deed).

Documents relevant to the Arrangement

5) The following documents are relevant to the Arrangement:

   a) Fonterra Shareholders' Fund Trust Deed dated 23 October 2012 and as amended and restated on 17 June 2019 (which established the FSF) (Trust Deed),

   b) Fonterra Shareholders' Fund Authorised Fund Contract dated 25 October 2012 and as amended and restated from 1 November 2016, under which the FSF was established as an "Authorised Fund" under Fonterra's Constitution,

   c) Deed of Trust establishing the Fonterra Farmer Custodian Trust dated 25 October 2012, which holds all shares in the Custodian and the Fonterra Unit,

   d) Custody Trust Deed for the Fonterra Economic Rights Trust dated 25 October 2012, under which the Custodian holds the legal title to Shares and holds the economic rights in Shares on trust for the Supervisor, and

   e) Constitution of Fonterra Co-operative Group Limited (Constitution), which was adopted in November 2020.

Background to the Arrangement

6) Fonterra is simultaneously registered as a co-operative dairy company under Part 3 of the Co-operative Companies Act 1996 and as a company under the Companies Act 1993. The Dairy Industry Restructuring Act 2001 (DIRA) governs many aspects of Fonterra's structure and operation.

7) Supplying Shareholders must generally hold such number of Shares as is determined by the share standard (currently set in Fonterra's Constitution as being one share for each kilogram of milksolids obtainable from milk supplied by the farmer in that season, save that Shares cannot be issued to a farmer whose supply of milksolids is less than 1,000kg in a season). These Shares are informally known as "wet" shares, as they are backed by the supply of milk. In practice, Supplying Shareholders must indicate in advance how much milk they wish to supply in a coming season, and they must acquire or dispose of the appropriate number of Shares to back that supply (within certain margins). Supplying Shareholders may also comply with the share standard through the holding of "vouchers" (discussed further in [30]).

8) In addition to their "wet" Shares, Supplying Shareholders may acquire further Shares (currently up to 100% of the number of shares that they must hold under the share standard). These Shares are informally known as "dry" Shares, as they are not backed by the supply of milk. Despite the informal distinction between wet Shares and dry Shares, all Shares of Fonterra belong to a single class of share.

9) In the past, s 98 of the DIRA required Fonterra to pay a surrender value for Shares when a Supplying Shareholder gave a notice of withdrawal under s 97 of the DIRA. The ability for farmers to surrender their Shares in this way led to volatility in Fonterra's capital, referred to by Fonterra as redemption risk.

10) To address this redemption risk, Fonterra changed its capital structure in three stages. The changes, referred to as Trading Among Farmers, included:

   a) enabling farmers to acquire up to 100% of the number of Shares they must hold under the share standard as dry Shares,

   b) establishing the FSF to enable public investment, and

c) creating a "private market" (the Fonterra Shareholders' Market (FSM)) for the trading of Shares between Supplying Shareholders, RVPs (whose Shares are held in the name of the Custodian in trust for the RVP) and Fonterra (together referred to as Permitted Persons). Fonterra is involved in the FSM so it can manage the size of the FSM by conducting buybacks of Shares.

11) The DIRA was also amended to remove the requirement for Fonterra to accept the surrender of Shares on request. This amendment was brought into force in November 2012 by Order-in-Council and removed the redemption risk.

The Arrangement

12) The FSF is a passive investment vehicle through which a Public Investor can invest indirectly in Fonterra. The FSF was established as a unit trust under the Unit Trusts Act 1960 on 23 October 2012 (though is no longer a "unit trust" under the Unit Trusts Act 1960 following the repeal of that Act).

13) The FSF has elected to be a "foreign investment variable-rate PIE" (as defined in s YA 1) and to use the exit calculation option (under s HM 42). The Commissioner confirmed this by letter dated 13 November 2012.

14) The purpose of the FSF is to support the FSM by acting as a conduit for Public Investors to access the underlying economic rights in a Share, thereby creating a more liquid market for Supplying Shareholders (and RVPs) to trade in Shares. This mechanism allows Supplying Shareholders to sell economic rights in Shares to the FSF, as well as selling Shares on the FSM. It also allows an RVP to move between the FSF and FSM to match supply and demand and possibly hedge its position. While Supplying Shareholders may invest in the FSF, most of the Unit Holders are not Supplying Shareholders.

Registered volume providers

15) Fonterra has appointed one RVP, Craigs Investment Partners (although it retains the discretion to appoint further RVPs), to acquire and dispose of Shares (through the Custodian) on the FSM to facilitate trades and liquidity in that market. The principal duties of RVPs are to ensure the smooth execution of transactions and improve liquidity through continuous quoting of buy and sell orders with a contracted maximum spread between the buy and sell prices quoted. A main role of RVPs is to ensure the spread between buy and sell prices is restricted to a narrow range.

16) Under the Constitution, RVPs must hold, in aggregate, rights or interests in no more than 5% of the total Shares on issue at any time, excluding treasury stock (such Shares being held in the name of the Custodian in trust for the RVP). Fonterra and the RVPs have not and will not enter into a risk-sharing agreement. However, where the RVP is suspended from selling economic rights in relation to Fonterra Shares to the FSF, Fonterra will compensate the RVP for certain trading losses suffered by the RVP.

17) As with Supplying Shareholders, RVPs can also participate in the FSF. This promotes price convergence between the FSM and the FSF.

Supervisor, Manager and Custodian

18) Fonterra appointed the initial Supervisor as trustee of the FSF. The Supervisor is licensed under the Financial Markets Supervisors Act 2011.

19) Fonterra also appointed the initial Manager of the FSF. The initial Manager is a company wholly owned by Trustees Executors Limited. Under the Financial Markets Conduct Act 2013, the role of the Manager is to manage the investments of the FSF and issue Units to the public. The Manager manages the FSF as an investment vehicle and does not undertake an active role (such as actively soliciting farmers to sell economic rights in their Shares). Fonterra provided a licence (the Licence) to the Manager to use Fonterra's name and brand for the purposes of the FSF.

20) The Supervisor and Manager are party to an arrangement (the Funding Arrangement) with Fonterra under which Fonterra provides the FSF with funds at the start of each financial year to cover the reasonable expenses incurred by the FSF, or the Manager, on behalf of the FSF (Operating Expenses) in accordance with a budget agreed between the parties.

21) The Custodian is a limited liability company set up to hold legal title to the Shares. The Custodian holds legal title to any Shares in which economic rights have been sold to the FSF and holds the economic rights in Shares on trust for the Supervisor (under the Fonterra Economic Rights Trust). The Custodian also holds legal title to any Shares acquired by the RVP on trust for the RVP (under a separate trust from the Fonterra Economic Rights Trust).

22) The Custodian is wholly owned by the Farmer Trustees, as trustees of the Fonterra Farmer Custodian Trust. The Fonterra Farmer Custodian Trust is a trust set up for the sole purpose of holding the shares in the Custodian and the Fonterra Unit.

The Farmer Trustees are three farmer representatives (a farmer directly elected by Supplying Shareholders, a director of Fonterra elected by Supplying Shareholders, and a member of the Fonterra Shareholders' Council). The discretionary beneficiaries of the trust are Supplying Shareholders, and Fonterra is the final beneficiary of the trust.

23) The Custodian (and the FSF) does not have voting rights in Fonterra under the Constitution, which restricts voting rights to Supplying Shareholders (that is, production-based voting rights), except at a meeting of an interest group where there would otherwise be no shareholder entitled to vote at that meeting under cl 24.2(c) of the Constitution. Under cl 7.8 of the Constitution, the Authorised Fund Contract is required to prohibit the FSF and the Custodian from exercising, controlling or exerting any influence over any voting rights attached to the Shares. The Trust Deed and Custody Trust Deed also contain provisions preventing the FSF and the Custodian from exercising any influence over voting rights attached to the Shares.

24) Under cl 7.1 of the Custody Trust Deed, the income of the Fonterra Economic Rights Trust includes amounts of deemed income that arise under tax law, and the Custodian is permitted to distribute this income to the FSF.

Operation of the Fonterra Shareholders' Fund

25) Supplying Shareholders, RVPs and Fonterra can transfer economic rights in Shares to the FSF. In this context, "economic rights in Shares" means the rights to receive dividends and other benefits derived from a Share, including any change in value of the Share, as well as the other rights and benefits attached to the Share. It does not include any right to hold the legal title to a Share or a security convertible to a Share or to exercise production-based voting rights.

26) The process for selling economic rights in Shares to the FSF involves two steps:

a) Supplying Shareholders, RVPs and Fonterra transfer legal title to a Share to the Custodian (legal title to the Share does not pass to the FSF).

b) The Custodian holds the economic rights in the Shares on trust for the Supervisor.

27) The economic rights in Shares are the FSF's only material asset. Under cl 7.5 of the Constitution, the aggregate number of Shares in which the FSF may acquire economic rights is limited to 20% of the total number of Shares on issue (excluding treasury stock). If this limit is exceeded, the board of Fonterra must, within an appropriate timeframe, take steps to bring the number of Shares in respect of which the economic rights are held for the FSF back within the limit (cl 7.6 of the Constitution).

28) The Manager issues Units in the FSF when the Custodian receives a Share, which gives rise to the receipt of economic rights in a Share by the FSF. In addition, if Fonterra issues further Shares in respect of a Share the Custodian holds (in respect of which economic rights are being held in favour of the Supervisor), the FSF will issue a corresponding number of Units to its Unit Holders under cl 15.1(d) and (e) of the Trust Deed. This ensures the number of Shares placed with the Custodian in which economic rights are being held in favour of the Supervisor always equals the number of Units on issue. Clause 15.1(a) and (b) of the Trust Deed provides for the payment of cash dividends or other cash benefits to Unit Holders, mirroring payments on the Shares, as follows:

a) upon receipt of a Cash dividend or other Cash Benefits (other than a Supplementary Dividend) paid by Fonterra, this will be distributed to Unit Holders who were recorded in the Register at the same time and on the same record date as applied by Fonterra to determine the entitlement to the cash dividend or other cash Benefits. The amount to be paid or transferred to each such Unit Holder in respect of each Unit held by that Unit Holder as at that time, will be equal to the amount Fonterra paid or transferred per Share adjusted to take into account any Tax Liability of the Trust relating to the Unit Holder or any adjustments in accordance with section HM 48 of the Tax Act, and less any non-resident withholding tax deducted in respect of the Unit Holder in accordance with subpart RF of the Tax Act pursuant to section HM 44B of the Tax Act and less any sum authorised in accordance with an Extraordinary Resolution pursuant to paragraph 11.1(b)(viii) of Schedule 1;

b) upon receipt of any Supplementary Dividend paid by Fonterra, this will be distributed to the Unit Holders that entitled Fonterra to apply section LP 2 of the Tax Act and receive a tax credit for the Supplementary Dividend;

29) Each Supplying Shareholder or RVP who transfers Shares to the Custodian (in which economic rights have been sold to the FSF) receives either one Unit in the FSF for each such economic right in a Share transferred or a cash sum (cl 5.1 of the Trust Deed) in recognition of the transfer of the economic right in the Share to the FSF. Supplying Shareholders cannot retain Units that they receive in consideration for the transfer of Shares to the Custodian (in which economic rights have been sold to the FSF). These Units must be sold on the NZX Main Board or ASX to settle a sale contract previously entered into in the relevant market.

30) Supplying Shareholders who sold economic rights in wet Shares to the FSF as part of the establishment of Trading Among Farmers (and as part of a subsequent one-off offer by Fonterra to purchase Units in October 2012) also received "vouchers" that count towards the share standard and support production-based voting rights and the right to full share backed milk price (cl 5.3 of the Trust Deed). Fonterra's Constitution gives the Fonterra Board the discretion to maintain a policy that would permit Supplying Shareholders to sell the economic rights in wet Shares to the FSF on a day-to-day basis and (subject to individual limits) to receive "vouchers" in partial consideration for the sale of those economic rights. While the Board keeps this policy under review, Supplying Shareholders are not currently entitled to sell economic rights in wet Shares to the FSF or to receive vouchers in connection with such sale.

31) Under the Trust Deed, each Unit the FSF issues evidences the holder's entitlement to the economic benefits (including distributions and other benefits) in the whole of the trust fund. As the number of Units the FSF issues equals the number of Shares the Custodian holds (in which economic rights are being held in favour of the Supervisor), in effect, each Unit provides rights to receive the distributions and other benefits in respect of one Share. Individuals and their associates must not hold more than 15% of the lesser of the total number of Units on issue or the total voting rights in the FSF (cl 6.1 of the Trust Deed).

32) The Units in the FSF (including the Fonterra Unit) carry in respect of the FSF a right to vote or participate in any decision-making concerning at least one of the following:

a) a dividend or other distribution to be paid or made by the FSF, or

b) any variation to the Trust Deed.

33) Clause 4.1(c) of the Trust Deed sets out that the Units do not confer any interest in certain amounts under the Trust Deed, as follows:

c) Unless the Manager directs otherwise, Units shall not confer any interest in interest income of the Trust. Units shall not confer any interest in monies paid to the Supervisor or the Manager to meet their fees or to reimburse either of those parties for (or any advance payment in respect of) any expenses, liabilities, losses and costs incurred by them respectively in or about acting as Supervisor or Manager (as the case may be) under this Deed. In all cases, all interest income and such monies will be applied by the Manager to meet the fees and expenses, liabilities, losses and costs incurred by the Manager or the Supervisor in or about acting as Manager or Supervisor (as the case may be).

34) The FSF Units trade on a registered market (the NZX Main Board and ASX) in which Supplying Shareholders, RVPs, Fonterra and other Public Investors may participate. Standard listing rules (but with various exemptions to those rules recognising that it is a unit trust and to accommodate other characteristics of Trading Among Farmers) apply to the FSF. Fonterra and the FSF co-operate with each other in relation to matters such as disclosure of information to enable the FSF to comply with the listing rules applicable to the FSF.

35) Supplying Shareholders, RVPs and Fonterra can exchange Units for Shares subject to various limits, but no other investor can (cl 9 of the Trust Deed). For example, if a Supplying Shareholder, Fonterra or an RVP wished to acquire a Share, it could do so either by buying a Share on the FSM or by buying a Unit and presenting that Unit to the Supervisor for redemption and demanding that the Supervisor procure the Custodian to transfer to it (or in the case of the RVP, to the Custodian to hold on trust for the RVP) one Share.

36) Under cls 6.5 and 7.8 of the Constitution and cl 15.2 of the Trust Deed, neither the RVPs nor the FSF (or the Custodian in relation to either) is entitled to exercise any voting rights attached to Shares that the Custodian, from time to time, holds for them (except on an interest group resolution where otherwise no shareholder can vote: cl 24.2(c) of the Constitution).

37) Except as noted in [35], no Unit Holder may require the transfer to themselves of any of the property of the FSF or any Share. The Supervisor covenants that it will not call for a transfer of the Shares (cl 4.8 of the Custody Trust Deed). In addition, no Unit Holder may redeem their Units for cash other than as described in cl 15.1(h) of the Trust Deed. However, Unit Holders may sell their Units to other investors on the NZX Main Board or ASX.

38) In addition to dividends, which are expected to be paid twice a year, other potential distributions in respect of the Shares include:

a) taxable and non-taxable bonus issues,

b) in-specie distributions of property,

c) share buy-backs,

d) dividend reinvestment schemes,

e) renounceable and non-renounceable rights issues, and

f) notional distributions.

39) Section 16 of the Dairy Industry Restructuring Amendment Act 2012 inserted ss 161A and 161B into the DIRA to allow Fonterra to hold Units in the FSF. Fonterra maintains a unit-holding in the FSF that may increase or decrease but will always hold at least one Unit. In respect of Units Fonterra holds, the DIRA prevents Fonterra from exercising any voting rights carried by those Units (s 161A(i)).

40) The FSF may derive income other than from the Shares the Custodian holds on its behalf such as interest on cash held in a bank account and amounts received under the Funding Arrangement (Other Income). To the extent the Fund derives Other Income, cl 4.1(c) of the Trust Deed provides that no Unit Holder has an interest in such Other Income, unless the Manager directs otherwise. Any Other Income that is available to the FSF is paid to the Supervisor as part of the fees due to the Supervisor.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

(a) The requirements of ss HM 55D(5), (6) and (7), HM 55E, HM 55F and HM 55FB are met in relation to notified foreign investors in the FSF.

(b) The FSF is not treated under any double tax agreement as not being resident in New Zealand.

(c) The FSF is not in the business of life insurance.

(d) 90% or more of the FSF's investments (by value of its assets) are investments of a type referred to in s HM 11, other than an interest in land in New Zealand or a right or option in relation to land in New Zealand, in accordance with s HM 19C(1).

(e) 90% or more of the income derived by the FSF is of a type referred to in s HM 12, other than an amount derived from an interest in land in New Zealand or the disposal of an interest in land in New Zealand, in accordance with s HM 19C(2). For the avoidance of doubt, this condition will not be breached if any failure to meet the requirement of s HM 12 is not "significant and within control of the FSF" and is remedied by the last day of the next quarter, in accordance with s HM 25.

(f) The FSF has not lost its PIE status through the application of s HM 25, s HM 27 and/or s HM 29.

(g) The FSF has not changed its election to use the exit calculation option in s HM 42.

How the Taxation Laws apply to the Arrangement

Subject in all respects to any conditions stated above, the Taxation Laws apply to the Arrangement as follows:

(a) The FSF qualifies as a "foreign investment variable-rate PIE" (as defined in s YA 1).

(b) The FSF's interest in the Shares is an investment of a type referred to in s HM 11.

(c) Income derived by the FSF from its interest in the Shares is income of a type referred to in s HM 12.

(d) Income attributed by the FSF to its investors is "excluded income" (as defined in s BD 1(3)) of the investor under s CX 56(3) provided that:

   (i) the prescribed investor rate for the investor is more than zero and not more than the investor's notified investor rate when the PIE calculates its income tax liability under s HM 47, or makes a voluntary payment under s HM 45, or

   (ii) the investor is one of those listed in s CX 56(1B), or

   (iii) the investor is one of those listed in s CX 56(1C) and has made the necessary election under s HC 33, and

   (iv) the amount is not an amount of attributed PIE income that is derived by a trustee who has chosen a prescribed investor rate referred to in sch 6, table 1, row 5 or 7, as applicable, and

   (v) the investor is not a new New Zealand resident to whom s HM 57B would have applied but who has chosen not to apply that section to determine their prescribed investor rate for a "resident year" (as defined in s HM 57B(3)), and

   (vi) the amount is not an amount of PIE schedular income derived by a natural person who is an investor in the PIE.

(e) Where a Permitted Person acquires a Share on redemption of a Unit, and is entitled to a deduction under ss DA 1 and/or DB 23, the cost or amount of expenditure incurred in acquiring the Share for the purposes of those sections will be the market value of the redeemed Unit on the day it was redeemed.

(f) The redemption of a Unit in the FSF by a Unit Holder, in exchange for a Share, will not give rise to a dividend under ss CD 4 to CD 6.

(g) Any distributions from the FSF are excluded income of each Unit Holder under s CX 56B (and therefore not taxable), other than where the FSF elects to pay non-resident withholding tax in accordance with s HM 44B in respect of the distribution.

(h) An investor in the FSF who is a natural person will have no adjustment to their terminal tax liability under s HM 36B in respect of income attributed by the FSF to the investor if that investor has notified the correct prescribed investor rate and the FSF has satisfied the investor's tax liability by applying that notified rate.

(i) The Arrangement is not subject to s BG 1.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 January 2021 and ending on 31 January 2026.

This Ruling is signed by me on the 26th day of March 2021

Fiona Wellgreen
Senior Tax Counsel

About this document

Product Rulings are issued by the Tax Counsel Office and Customer and Compliance Services. Product Rulings set out the Commissioner's view on how tax laws apply to a particular "product" – which is an arrangement that a specified taxpayer is likely to enter into with a number of people on identical terms. Taxpayers who enter into the arrangement described in a Product Ruling may apply the ruling, but are not obliged to do so. Product Rulings are binding on the Commissioner. This means that if you are entitled to apply a Product Ruling and you have calculated your tax liability in accordance with the ruling, the Commissioner must accept that assessment. A Product Ruling applies only to the taxation laws and arrangement set out in the ruling, and only for the period specified in the ruling. It is important to note that a general similarity to an arrangement covered by a Product Ruling will not necessarily lead to the same tax result.

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.

COV 21/01: Variation to sections 33E and 68CC(3) of the Tax Administration Act 1994

EFFECTIVE: 21 April 2021 to 30 September 2021

Determination

The Commissioner of Inland Revenue has, under the discretion provided under section 6I of the Tax Administration Act 1994, made the following statutory variation:

For a criteria and methodologies notice in relation to the R&D tax credit for the 2020-2021 income tax year under section 68CC(3) of the Tax Administration Act 1994, the date by which that notice must be filed with the Commissioner is extended to the 7th day of the fifth month after the end of the income year for a person with a standard or late balance date, or 7 August 2021 for a person with an early balance date, but in no case beyond 30 September 2021.

For a supplementary return for the 2019-2020 tax year under s 33E of the Tax Administration Act 1994, the date by which a supplementary return must be filed is amended to be the day that is 90 days after—

(a) the due date on which they are required to file a return of income for the tax year under section 37; or

(b) the due date on which they would be required to file a return under section 37, if they had assessable income.

This variation applies in circumstances where the planning or conduct of eligible research and development or the ability to appropriately obtain necessary information, seek advice and formulate an application or prepare a return under sections 33E or 68CC of the Tax Administration Act 1994 on time has been materially delayed or disrupted by the COVID-19 outbreak and its effects.

Application date

This variation applies from 21 April 2021 to 30 September 2021

Dated at Wellington on 21 April 2021

Jonathan Rodgers
Group Leader – Tax Counsel Office
Inland Revenue

Background (material under this heading does not form part of the variation)

Summary of effect

1. This variation extends:
   - by three months (to 7 August 2021 for a standard balance date) the times by which a person with a standard or late balance date , to be entitled to research and development tax credits under s LY 1 of the Income Tax Act 2007, must apply for criteria and methodology approvals for the 2020-2021 income year (but not beyond 30 September 2021 in any case);
   - to 7 August 2021 the time by which a person with an early balance date, to be entitled to research and development tax credits under s LY 1 of the Income Tax Act 2007, must apply for a criteria and methodologies approval for the 2020-2021 income year; and
   - by 60 days the time by which a person must make supplementary returns for the 2019-2020 tax year.

Provisions affected

2. Sections 33E and 68CC of the Tax Administration Act 1994

Application of variation:

3. This variation applies to a person who is seeking the Commissioner's approval of their research and development activities by filing a criteria and methodologies application for the 2020-2021 income year under s 68CC of the Tax Administration Act 1994, or who is filing a research and development supplementary return for the 2019-2020 tax year. The variation recognises that the impact of COVID-19 means the planning or conduct of research and development or the ability to obtain information, seek advice and formulate an application may have been delayed.

Associated variations:

4. See also COV 20/10 "Variation to section 68CB(2) of the Tax Administration Act 1994" dated 1 September 2020.

Legislative References

Tax Administration Act 1994: ss 6H and 6I

COV 21/02: Variation to section FN 7(5) of the Income Tax Act 2007

EFFECTIVE: 28 April 2021 to 30 September 2021

Determination

The Commissioner of Inland Revenue has, under the discretion provided under section 6I of the Tax Administration Act 1994, made the following statutory variation:

> Section FN 7(5) of the Income Tax Act 2007 is varied to state that a notice of election under subsection (1) has effect from the start of the tax year ending 31 March 2020.
>
> This variation applies until 30 September 2021 and only applies in the situation where:
>
> - a company or a consolidated group of companies has a debit balance in their imputation credit account at the end of March 2020;
> - at that date, there were reasonable grounds for expecting that by the end of their income year they would have profits that were more than the amount they would need to purchase tax from a tax pool to reduce the debit balance;
> - instead of making such profits, they end up with significantly reduced profits due to the effects of COVID-19 such that using a tax pool, whether through tax pool financing or a debt facility, or any other option will adversely affect their cashflow;
> - the eligibility requirements in s FN 4(1) to form an imputation group with another company in a wholly-owned group would have been satisfied at 31 March 2020 if they had made an election to form an imputation group with that company; and
> - The other company in the wholly-owned group had imputation credits that could have been used to reduce the debit balance at the end of March 2020 if an election to form an imputation group had been made before 31 March 2020.

Application date

This variation applies from 28 April 2021 to 30 September 2021

Dated at Wellington on 28 April 2021

Jonathan Rodgers
Group Leader – Tax Counsel Office
Inland Revenue

Background (material under this heading does not form part of the variation)

Summary of effect

1. The effect of the variation will be to assist cashflow for customers whose profits for the 2020 income year were adversely affected by COVID-19 and who had an imputation debit balance in their imputation credit account at 31 March 2020 but did not give the Commissioner the notice of election to form an imputation group that they could have given by that date to allow credits in a related company to be used to reduce the debit balance.
2. They will be able to give a notice of an election to form an imputation group that will be effective from the start of the tax year ending 31 March 2020, allowing use of the credits of the related company to reduce the debit balance.

Provision affected

3. Section FN 7 of the Income Tax Act 2007.

Application of variation:

4. This variation recognises that some customers who did not take steps to address a debit balance in their imputation credit account before 31 March 2020 could have used a tax pool or other option to reduce the balance subsequently but the impact of COVID-19 on their profits has been such that these options will adversely affect their cashflow.
5. The variation will assist by changing the date specified in s FN 7(5) from which a notice of election to form an imputation group under s FN 7(1) may have effect, allowing available credits in the imputation credit account of a related company to offset the debit balance. This is provided they otherwise met the requirements to imputation group as at 31 March 2020 and the related company has sufficient credits available.

Legislative References

Tax Administration Act 1994: ss 6H and 6I

2021 Consumers Price Index Adjustment to standard-cost amounts for household services (childcare, boarding services, or short-stay accommodation)

In accordance with Section 91AA of the Tax Administration Act 1994, the Commissioner advises adjustments to have been made to the standard-cost amounts for the 2021 income year (1 April 2020 to 31 March 2021), as follows:

Determination DET 09/02 (CPI 2021) Childcare household service

- Hourly standard cost (per child)	$3.75
- Annual fixed administration and record keeping standard-cost	$367.00

Determination DET 19/01 (CPI 2021) Household boarding service providers

- Weekly standard-cost (per boarder)	$194.00

Determination DET 19/02 (CPI 2021) Short-stay accommodation

- daily standard-cost (for each guest)	
Owned dwelling	$52.00
Rented dwelling	$47.00

These amounts reflect the annual movement of the Consumers Price Index for the twelve months to March 2021, which showed an increase of 1.5%.

QUESTION WE'VE BEEN ASKED

This section of the *TIB* sets out the answers to some day-to-day questions people have asked. They are published here as they may be of general interest to readers.

QB 21/02: Whether "negative interest" payments are subject to withholding taxes

This Question We've Been Asked (QWBA) explains the application of the resident withholding tax (RWT) and non-resident withholding tax (NRWT) rules to situations where negative interest is charged on an advance of money or a loan.

The Commissioner has been asked this question by banks and financial institutions because they wish to have appropriate processes in place should the RWT and NRWT rules apply to negative interest payments and they are required to withhold tax.

Key provisions

Income Tax Act 2007 – subparts RE and RF, s YA 1 definitions of "interest" and "money lent".

Legislative references are to the Income Tax Act 2007, unless otherwise specified

Question

Is a "negative interest" payment subject to resident withholding tax (RWT) or non-resident withholding tax (NRWT)?

Answer

No. The payment will not be subject to withholding taxes. For the RWT and NRWT rules to apply the payment must be made to a person by another person for money lent. Negative interest cannot truly be said to be paid for money lent. If it was paid "for" money lent then it would be in return for the money lent. However, negative interest is paid to the person receiving the money and it is not a return to a lender from a loan. This conclusion is consistent with the legislative history and case law on the meaning of "interest".

Key terms

RWT and **NRWT** are taxes that are deducted from investment income before the investor receives it. In the case of interest, a bank or financial institution will usually deduct RWT or NRWT at the applicable rate before paying the interest to the investor.

Negative interest payment means a payment made as a term of a financial transaction (arrangement) where money is advanced at a negative rate of interest. A negative interest payment is made by the person advancing the money to the person receiving the money. It effectively reverses the usual position for interest where the borrower pays interest to the lender.

Background

1. The official cash rate is an interest rate the Reserve Bank of New Zealand sets for use between banks (in the wholesale market). Other interest rates in the retail market – between banks and customers – are priced with reference to the official cash rate.
2. New Zealand has never had negative interest rates and, while unusual, such practice is being considered widely overseas. Banks and financial institutions are putting in place processes for the possibility of a negative official cash rate, and the Commissioner has been asked whether withholding taxes will apply to negative interest payments. This issue is less relevant for other taxpayers as they do not usually need to consider whether to withhold RWT or NRWT.
3. The scope of this question is concerned with only whether it is necessary to withhold RWT and NRWT and is not intended to address the tax consequences of negative interest generally.

Explanation

RWT and NRWT rules

4. Normally, interest payments would be subject to withholding under the RWT and NRWT rules. The question is whether negative interest payments come within the RWT or NRWT rules by virtue of being:
   - "resident passive income" as defined in s RE 2; or
   - "non-resident passive income" as defined in s RF 2.
5. This turns on whether the negative interest payment is "interest" for "money lent" (both as defined in s YA 1).

"Interest" for "money lent"

6. The s YA 1 definitions of "interest" and "money lent" are wide and relevantly state:

   interest,—

   (a) for a person's income,—

   (i) means a payment made to the person by another person **for** money lent **to** any person, whether or not the payment is periodical and however it is described or calculated; and

   (ii) does not include a redemption payment; and

   (iii) does not include a repayment of money lent:

   …

   money lent means—

   (a) an amount of money that a person lends in some way, including by depositing it in an account, whether or not the lending is secured or evidenced in writing: [Emphasis added]
7. The definition of "money lent" states that an amount will be money lent, if it is an amount of money that a person "lends" in some way. Depending on the particulars of the transaction, it is arguable that the money advanced in a negative interest transaction is money lent. Similarly, there is an argument that negative interest would be the **payment** required under the definition of interest. However, the Commissioner's view is that a negative interest is not truly a payment made to the borrower "for" money lent "to" the borrower.

Meaning of "for"

8. If "for" in this context requires or implies the giving of interest in exchange – and countervailing with – the money lent, then negative interest is not paid "for" the relevant money lent. Put simply, the negative interest payment will not be in exchange for the money lent because both payments flow in the same direction; that is, one party pays both the money and negative interest to the recipient of the funds.
9. "For" is not defined in the Act. Dictionary definitions indicate that the word "for" can have a variety of meanings depending on the context in which it is found. Definitions range from "in exchange for", which suggests a direct connection, to "having as a purpose or function" and "with regard to", which permit a wider connection. The case law on the meaning of "for" recognises that it is a "rubbery" word that has a variety of meanings depending on the context (*Wilson & Horton v CIR* (1995) 17 NZTC 12,325 (CA)).
10. On the one hand, it could be argued negative interest is paid "with regard" to the money lent. There is a nexus in the sense that, absent money lent in a particular arrangement between two parties, negative interest would not be paid under that arrangement.
11. However, the Commissioner considers that the better view is that, in this context, "for" implies the giving of interest in exchange – and countervailing with – the money lent. The word "to" – in the context of the phrase "payment … for money lent to" – arguably provides some interpretive support for this interpretation of "for". The "for … to" language provides a suggestion that the most appropriate meaning of "for" in this context is in a countervailing, exchange-type manner. Other factors support this interpretation of "for":
    - The previous definition of "interest" in s OB 1 of Income Tax Act 1994 is narrower than the current definition and appears to envisage interest being paid to the lender.
    - The immediate legislative context appears to support the proposition that the legislation is concerned with interest paid to the lender and not with payments made to the borrower. Paragraphs (b) and (bb) of the current s YA 1 definition of "interest" both appear to equate the person making payment as being the person who was lent the money.

- In terms of purpose, the definitions of "interest" and "money lent" were introduced to the Income Tax Act 1976 by the Income Tax Amendment Act 1983 with the apparent intent of taxing returns to the lender.[1]

12. Based on this interpretation of "for", a negative interest payment will not be "for" money lent. The negative interest flows in the same direction as the money lent, so it is not given in exchange for the money lent (rather, the payment appears to be made for receiving, accepting or holding the money). "Interest" should, in this context, be the price or compensation for providing money lent – on a time value of money basis or otherwise – and that does not appear to be the case for negative interest.
13. In summary, the Commissioner considers that negative interest does not meet the s YA 1 definition of interest because it is not a payment for money lent. In simple terms, it will be "interest" where the borrower pays the lender for the money lent. In this case, the lender is paying the borrower for the receiving, acceptance or holding of the money.

RWT and NRWT will not apply

14. Negative interest will not be resident passive income or non-resident passive income and subject to RWT and NRWT. Negative interest payments will still be subject to income tax but there is no withholding requirement on such payments. A further consequence of this conclusion is that the reporting requirements on banks and financial institutions for interest do not apply to negative interest payments.

Examples

EXAMPLE 1 - RWT treatment where a financial institution is party to a negative interest transaction

XYZ Regional Finance Ltd (XYZ) is a small sized financial institution based in New Zealand. It is involved in wholesale banking (that is, lending between banks and financial institutions) and retail banking (that is, financial services provided to customers and individuals).

As part of its banking requirements XYZ is required to deposit surplus funds overnight with one of the main registered banks. In normal circumstances XYZ will receive interest (at positive interest rates) less any applicable RWT or NRWT. XYZ wants to know whether there will be withholding taxes if the Reserve Bank introduces a negative official cash rate that flows into the wholesale lending market. In this scenario, XYZ expects it would be charged interest from the large national banks at -0.25% for its overnight deposits. This would mean XYZ depositing the money and the bank charging XYZ negative interest in return for XYZ depositing the money.

Notwithstanding that the registered bank may have a certificate of exemption from RWT, withholding would not apply because the negative interest is not resident passive income (so is not subject to RWT) because it cannot be said to be interest for money lent. XYZ advances the money lent to the registered bank, and the negative interest is not provided "for" the money lent as it is not provided from the registered bank (the borrower) to XYZ (the lender).

The negative interest payment received by the registered bank will still be subject to income tax but XYZ has no withholding requirement because the RWT rules will not apply.

EXAMPLE 2 - RWT treatment for a loan to a company

The nature of Company A's business is that, from time to time, it needs to borrow funds to meet its immediate day-to-day cashflow requirements. It has a loan facility with Company B for this purpose (Company B has an exemption certificate but Company A does not). The longstanding agreement between the companies is that Company A pays a rate of interest that is 0.25% higher than the Official Cash Rate. In the event of a negative OCR there is a possibility that there will be a negative interest rate and the companies want to know whether withholding will apply.

There is no withholding. Negative interest is not an amount paid in return for the money lent – it is Company B (the lender), rather than Company A (the borrower), that is making the payment. Consequently, negative interest is not resident passive income and is not subject to withholding (although it will still be taxable).

[1] See the Rt Hon RD Muldoon's Budget speech introducing the new definition of "interest" in *Parliamentary Papers B.6, Financial Statement* (House of Representatives, Wellington, 28 July 1983):, p 26. This passage was also discussed in *Marac Life Assurance Ltd v CIR* [1986] 1 NZLR 694 (CA).

References

Legislative references

Income Tax Act 1976

Income Tax Act 1994, s OB 1 (“interest”)

Income Tax Act 2007, subparts RE (s RE 2) and RF (s RF 2), s YA 1 (“interest”, “money lent”)

Income Tax Amendment Act 1983

Case references

Marac Life Assurance Ltd v CIR [1986] 1 NZLR 694 (CA).

Wilson & Horton v CIR (1995) 17 NZTC 12,325 (CA).

Other references

Concise Oxford Dictionary (12th ed, Oxford University Press, 2011).

Rt Hon RD Muldoon, Budget speech introducing the new definition of ‘interest’, *Parliamentary Papers B.6, Financial Statement* (House of Representatives, Wellington, 28 July 1983): p 26.

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QB 21/023: Charities business exemption – business carried on in partnership

This Question We've Been Asked considers whether income derived by a charitable entity from a business will be exempt under s CW 42 if the business is carried on by a charitable entity in partnership with a non-charitable entity.

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

Key provisions

Income Tax Act 2007 – s CW 42

Question

Can income derived by a charitable entity from a business be exempt under s CW 42 if the business is carried on by a charitable entity in partnership with a non-charitable entity?

Answer

Yes. Income can be exempt if other requirements (such as the control and territorial restrictions) are satisfied.

Key terms

Charitable entity – A trust, society or institution of a kind referred to in s CW 41(1) that is also a tax charity as defined in s CW 41(5).

Control restriction – A restriction whereby income will not be exempt if a person with some control over the business is able to direct or divert money away from the charity (s CW 42).

Controlling entity – A charitable entity that is the recipient of income derived from a business carried on by an operating entity.

Operating entity – A charitable entity that carries on a business and pays income derived from the business to a controlling entity.

Partnership – A partnership as defined in the Act, which includes a limited partnership.

Territorial restriction – A restriction whereby income can be exempt only to the extent that the charity carries out its charitable purposes in New Zealand (s CW 42).

Explanation

1. Uncertainty exists about whether income derived by a charitable entity from a business will be exempt under s CW 42 if the business is carried on in partnership with a non-charitable entity.
2. The uncertainty arises because of statements made in cases (discussed in [4] to [6]), which suggest a need for a business to be carried on exclusively for a charitable entity, if income derived from the business is to be exempt. It is not clear how this requirement applies in the context of a business carried on in partnership with a non-charitable entity.
3. It is noted that the exclusivity issue is not answered by the tax treatment of partnerships set out in s HG 2. Although a partner of a partnership is treated under s HG 2 as carrying on the business carried on by the partnership, it does not follow that other partners are to be ignored. Each of the partners are treated as carrying on the business carried on by the partnership. Therefore, the question remains whether the participation of a non-charitable partner raises an issue in terms of exclusivity.
4. *Calder Construction Co Ltd v CIR* [1963] NZLR 921 (SC) is authority for the proposition that a business carried on for, or for the benefit of, a charitable entity can accumulate income in the business rather than distributing it each year, provided the resulting assets of the business are ultimately applied to the charitable entity. In this context, the court stated (at 925) that "it is the business which must be carried on in trust for charitable purposes". It might be argued that this statement is authority for a requirement – of general application – that a business must be carried on exclusively for charitable purposes.
5. *CIR v NTN Bearing-Saeco (NZ) Ltd* (1986) 8 NZTC 5,039 (HC) is another case sometimes referred to in this context. It highlights the importance of having a constitution that clearly provides for the application of both the income and the capital of a business to the charitable entity.
6. In *Latimer v CIR* (2002) 20 NZTC 17,737 (CA), the court stated that the operations of a business must be wholly devoted to making money for charitable purposes. The court stated that it would be difficult, if not impossible, to treat part of the

income as having been earned for one purpose and part for another purpose. As in *Calder, Latimer* suggests a business must be carried on exclusively for charitable purposes for s CW 42 to apply.

7. However, the context of these cases is different from the scenario considered in this item. None of these cases involved a business being carried on in partnership with a non-charitable entity.
8. The different context is significant. The court in Latimer stated that in most situations it would be difficult, if not impossible, to treat part of the income as having been earned for one purpose and part for another. This may be true in many situations. However, where a business is carried on by a charitable entity and a non-charitable entity in partnership, the income and capital of a business is allocated in accordance with each partner's partnership share. In this partnership situation, allocation is possible and not particularly difficult. Further, the purposes of the charitable entity and non-charitable entity can be compatible as they will generally both have an immediate intention of making a profit from the business.
9. It is considered that a court, if presented with the partnership scenario, is likely to accept that the exclusivity requirement suggested in the above cases applies only to the charitable entity's partnership share of the income and capital of the business.
10. This interpretation is consistent with the ordinary meaning of the words in s CW 42, which do not contain any exclusivity language. Based on the ordinary meaning, income can be derived from a business carried on by a charitable entity, despite the business also being carried on by a non-charitable entity.
11. Therefore, the Commissioner's view is that income derived from a business carried on by a charitable entity in partnership with a non-charitable entity can be exempt under s CW 42. This is illustrated in Example 2.
12. For the avoidance of doubt, in determining whether income derived by a charitable partner is exempt, for the "tax charity" requirement in s CW 42 to be satisfied it is sufficient for the charitable partner to be a tax charity. The partnership does not need to be a charitable entity (if that is possible).
13. This answer also applies where the business is being carried on by a charitable entity (the operating entity) in partnership with a non-charity and the charitable entity is doing so for, or for the benefit of, another charitable entity (the controlling entity).
14. This answer applies to general and limited partnership situations. This means that the charitable entity that is carrying on the business might be a limited partner (under s HG 2 each partner in a partnership – including a limited partnership – are treated as carrying on the business carried on by the partnership). Also note that the exemption of income in this situation will be subject to s CW 42, even though the limited partner may be only a passive investor in the partnership.

Examples

Example 1: Charitable entity carrying on a business on its own

Facts

The Takahē Trust is a charitable entity dedicated to the preservation of the takahē, a native New Zealand bird. The trust runs a small gift shop and cafe business. The profits from the business are used to fund preservation activities.

Tax treatment

The income derived from the business will be exempt under s CW 42 provided the territorial and control restrictions do not apply.

Example 2: Charitable entity carrying on a business in partnership

Facts

The Takahē Trust (from Example 1) decides to partner with a local catering company so it can focus more on takahē. The trust and the catering company each have a 50% partnership share.

Tax treatment

The income derived from the business by the Takehē Trust (calculated with reference to its 50% partnership share) will be exempt provided the territorial and control restrictions do not apply.

References

Legislative references

Income Tax Act 2007 – ss CW 41(1) and (5), CW 42

Case references

Calder Construction Co Ltd v CIR [1963] NZLR 921 (SC)

CIR v NTN Bearing-Saeco (NZ) Ltd (1986) 8 NZTC 5,039 (HC)

Latimer v CIR (2002) 20 NZTC 17,737 (CA)

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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 21/02: Retention of business records in electronic formats, application to store records offshore and keeping records in languages other than English or te reo Māori

Standard practice statements describe how the Commissioner of Inland Revenue (the Commissioner) will exercise a statutory discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

This Statement provides guidelines on the retention of business records in electronic format and sets out the Commissioner's practice when considering an application to store business records offshore and when considering an application to keep records in a language other than English or te reo Māori.

START DATE: 6/5/2021

REPLACES: SPS 13/01: Retention of business records in electronic format, application to store records offshore and application to keep records in Māori

Introduction

This Statement provides guidelines on the retention of business records in electronic format and sets out the Commissioner's practice when considering an application to store business records offshore and when considering an application to keep records in a language other than English or te reo Māori.

All legislative references are to the Tax Administration Act 1994 (the "TAA"), unless otherwise stated. The relevant legislative provisions of the Act are set out in the Legislative References page at the back of this Statement.

This Statement also appears in *Tax Information Bulletin* Vol. 33, No. 4 (June 2021).

Application

This Statement applies from 6 May 2021 and replaces SPS 13/01: Retention of business records in electronic format, application to store records offshore and application to keep records in Māori, published in *Tax Information Bulletin* Vol 25, No 3 (April 2013). It applies to customers who are required to keep business and other records under the Inland Revenue Acts and other third parties that hold business records for customers offshore.

Standard practice

Summary

1. This Statement applies to the Commissioner's discretion to allow customers to store information in a digital format and also sets out how the discretion to store business records offshore will be applied. It also confirms that as official languages of New Zealand, customers may keep their records in English or te reo Māori. It also provides guidelines for customers who wish to keep their records in a language other than English or te reo Māori.
2. The TAA and the Goods and Services Tax Act 1985 (GSTA) require customers to keep business and GST records in New Zealand and in either English or te reo Māori. The Commissioner has the discretion to authorise the offshore storage of records or to authorise records being kept in a language other than English or te reo Māori. The TAA allows applications to be made by a third party data storage provider, such as a cloud service provider, to store records offshore for their clients.
3. Records stored electronically, both inside and outside of New Zealand, and either on the customer's own electronic storage system or on an outsourced system, must meet the requirements of the Contract and Commercial Law Act 2017 (CCLA). This provides that the integrity of the information contained in the records is to be maintained and that the information

is readily accessible so as to be usable for subsequent reference. Further conditions for legal requirements to retain records under the Inland Revenue Acts are provided in schedule 2, clause 4 of the Contract and Commercial Law (Electronic Transactions) Regulations 2017 (CCLETR).

4. It is the Commissioner's view that the requirements in the CCLA and the conditions in the CCLETR are met if the practices in [26] to [37] of this statement are followed.
5. The Commissioner may authorise a customer to store records offshore or a third party to hold records offshore for multiple customers, if the storage of those records offshore does not impede the Commissioner's compliance activities. In particular, the records stored offshore must remain accessible by the Commissioner. An applicant will be required to demonstrate that the manner in which the records are to be stored offshore will meet the requirements of the CCLA and the CCLETR. Each application will be considered on a case by case basis having regard to the merits of the case, including the compliance history of the applicant.
6. For a third party application, the Commissioner will also consider whether the third party carries on business in, or through, an establishment in New Zealand. The Commissioner will also take account of the procedure that the third party has for dealing with client data should they cease to hold records for a client.
7. The Commissioner may impose conditions on an authorisation to store records offshore. The need to impose such conditions is determined on a case by case basis.
8. The Commissioner may withdraw an authorisation, either upon request by the party to which the authorisation applies or by giving reasonable notice of the withdrawal.
9. An authorisation given to a third party does not replace a customer's responsibility to meet the record keeping requirements as prescribed in the Inland Revenue Acts. The authorisation merely enables the third party to store the customer's records offshore without the customer being in breach of their obligations.
10. Pursuant to s 17B, the Commissioner can request information from any person, including a third party. Generally, the records of a specific customer will be obtained from that individual customer in the first instance. The Commissioner may request this information from a third party if it is necessary in the particular circumstances of the case.
11. The Commissioner will follow the standard practice for protecting customers' rights to non-disclosure of tax advice documents and documents that are legally privileged when requesting information[1].
12. The Commissioner may authorise records to be kept in a language other than English or te reo Māori. Applications to keep records in other languages will be approved only in limited circumstances where there are compelling reasons to do so. These applications will be considered on the facts of each case.
13. All customers must use certain English phrases specifically required by the GSTA and numbers must be recorded using Arabic numerals. This will be the case even where the Commissioner has agreed to keep records in another language, or whether the customer has elected to keep their records in te reo Māori.

Detailed discussion

Obligation to keep business and other records

14. Section 22 requires a person who carries on a business in New Zealand (including those who do business via the Internet) to keep sufficient business records to enable the Commissioner to readily ascertain the amount of tax payable by the business and all other tax matters relating to that business.
15. Records include, but are not limited to:
    - books of accounts that record receipts or payments or income or expenditure;
    - vouchers, bank statements, invoices, receipts, and other documents to verify entries in the books of accounts;
    - other accounts and documents specifically required to be maintained and kept.
16. Section 22(1) requires that the records to be kept in relation to a business must contain certain information. This includes:
    - a record of the assets and liabilities of the business; and
    - a record of all entries from day to day of all sums of money received and expended in relation to the business; and
    - all records and invoices relating to trading stock or the provision of services, depending on the type of business; and
    - charts and codes of accounts, the accounting instruction manuals, and the system and programme documentation which describes the accounting system used in each income year.

[1] Refer to Operating Statement (OS) 18/02 Non-disclosure right for tax advice documents

17. Business records must be retained in English or te reo Māori and at a place in New Zealand (unless the Commissioner has approved otherwise), and they must be retained for the full retention period required by the TAA, currently 7 years unless extended to 10 years by the Commissioner for specific situations.
18. Similar record keeping requirements are contained in s 75 of the GSTA for the retention of records specified in that section for GST purposes.
19. Records may be kept in paper form or electronic form. There must be sufficient detail to ensure a complete audit trail that allows tracing the retained records to and from accounting records and to tax returns.
20. Section 229 of the CCLA provides the option of using technology to store source paper documents by electronic means. The legal requirement to retain a document that is in paper form, is met by retaining an electronic form of the information if:
    - the electronic form provides a reliable means of assuring the maintenance of the integrity of the information; and
    - the information is readily accessible so as to be usable for subsequent reference.
21. Subject to s 231 of the CCLA, s 230 of the same Act sets the standard for retaining information in electronic form. The legal requirement to retain information that is in electronic form is met by retaining the information:
    - in paper or non-electronic form if the form provides a reliable means of assuring the maintenance of the integrity of the information; and
    - the information is readily accessible so as to be usable for subsequent reference.
22. Section 231 of the CCLA provides extra conditions for electronic communications. If a person is required to retain information that is contained in an electronic communication the person must also retain information that can identify the origin, destination, and the time when the electronic communication was sent. This information must be readily accessible and usable for subsequent reference.
23. Schedule 2, clause 4 of the CCLETR provides conditions for legal requirements to retain records under the Inland Revenue Acts:
    - A record that is initially in paper or other non-electronic form may be retained in electronic form if the record is readily able to be produced in paper form and that the paper form is a duplicate image of the original paper or other non-electronic form.
    - If annotations, indexing references or other additional information are included in the electronic form of the record, they must not obscure any of the original information contained in the record and must be distinguishable as additions to the original record.
    - A record that is generated in electronic form and is provided to another person in paper or other non-electronic form may be retained in its electronic form only.
    - If a record is received from a person in both non-electronic form and electronic form, the record may be retained in its electronic form only.

Retention of records in electronic form

24. The main requirements for keeping records in electronic form under the CCLA, whether the records were originally in paper form or in electronic form, are that:
    - the integrity of the information contained in the records is to be maintained; and
    - the information is readily accessible so as to be usable for subsequent reference.
25. The Commissioner considers that the information will meet the requirements of the CCLA and the CCLETR if the practices in [26] to [37] are followed. The same standards of record keeping practice applies to records stored both inside and outside of New Zealand, and either on the customer's own electronic storage system or on an outsourced system.

Originally in paper form

26. Paper records transferred to electronic form must be copied completely and accurately, for example, the use of imaging to provide information in a format identical in all respects to the source-paper document. A black and white scan of a coloured document is acceptable, unless the colours in the original document are material to understanding the information. The addition of information such as index referencing is also acceptable, provided the additional information does not obscure the original information and the additional information must be distinguishable as additions to the original record.

27. The electronic copy must be readily accessible and capable of being retrieved on legible hard copy (printouts) or supplied in an electronic form able to be read by Inland Revenue staff.
28. Source-paper documents or other non-electronic records from which the complete information is transferred and stored in electronic form, may be destroyed after transfer to the electronic form.
29. As an example, where a customer electronically transmits to the Commissioner information contained in any return in a prescribed form, s 36 of the TAA requires the customer to retain a hard-copy transcript of their information, and for a period of 7 years as required under s 22 of the TAA. The Commissioner considers that the requirement to keep the hard-copy transcript is met if the practices in [26] and [27] are followed.

Originally in electronic form

30. Internal controls must be adequate to ensure that all business transactions executed electronically, including those executed through the internet, are completely and accurately captured.
31. People should be able to demonstrate that their electronic records systems are secure from both unauthorised access and data alterations. This usually involves developing and documenting a security program that:
    - establishes controls to ensure that only authorised personnel have access to electronic records;
    - provides for backup and recovery of records;
    - ensures that personnel are trained to safeguard sensitive or classified electronic records; and
    - minimises the risk of unauthorised alteration, addition or erasure.
32. The charts and codes of accounts, the accounting instruction manuals, and the system and programme documentation which describes the accounting system used, must be retained and produced (if required) to Inland Revenue staff.
33. Those who engage in the electronic transfer of tax invoices, credit notes or debit notes must retain electronic records that have an adequate level of detail to meet the requirements of the GSTA. This may require the customer to keep other records such as the underlying contracts, price lists, price changes, and product code descriptions.
34. Where tax invoices are held in an electronic format there is no requirement to also hold a copy of the invoice in either paper or.pdf format provided that the required details of the invoice are readily accessible so as to be useable for subsequent reference.

Emails

35. An email that contains information required to be kept by the Inland Revenue Acts may be regarded as a record. Where emails are considered to be records s 231 of the CCLA requires the origin, destination and time of electronic communications to be retained and accessible so it can be used for subsequent references.

Backup

36. Backup and recovery procedures must be sufficient to ensure the availability of electronic records for the required record retention period.

Hardware/software changes

37. In the event of hardware/software changes:
    - facilities for retrieving electronic records that have been stored on the former system must be retained; or
    - the electronic records must be converted to a compatible system and both sets of files retained complete with documentation showing the method of transfer and controls in place to ensure the transfer was complete and accurate.

The Commissioner's discretion to authorise offshore record keeping

38. Section 22(2BA)(b) requires a customer to keep their business records in New Zealand, unless the Commissioner has authorised under s 22(8) that the records may be kept offshore. This applies to business records in both paper form and electronic form.
39. Authorisation may be given to an individual customer to hold their own records offshore or to a person (a third party) to hold records for multiple clients offshore.
40. An individual customer who wants to store their business records offshore should apply to the Commissioner for authorisation to do so before sending their records outside of New Zealand.

41. A third party may include a cloud service provider or other data storage providers that hold records for multiple customers.
42. It may be necessary for a tax agent to make a third party application if that tax agent is storing their clients' records for their clients outside New Zealand, i.e., where the clients of the tax agent have outsourced the storage of records to the tax agent and the clients are not holding their own records.
43. If either a backup of the business records is retained in New Zealand, or if the records to be stored offshore are merely a backup of the records held in New Zealand, the Commissioner considers that the requirement to store the records in New Zealand is satisfied and an authorisation is not necessary. This applies to both individual customers and to third parties.
44. If an authorisation is granted to a third party the individual customers for whom the third party holds records for would not need a separate authorisation from the Commissioner.
45. However, third party applications should be sent to the Business Lifecycle Manager, Significant Enterprises at:

    Inland Revenue
    5 Osterley Way Manakau
    PO Box 76198
    Manakau City 2241

46. Individual applications may be made through MyIR, telephone or in writing to your local Inland Revenue office.

The Commissioner's Consideration

47. The Commissioner may agree to a customer storing their business records offshore where the Commissioner is satisfied that the offshore storage would not impede compliance activities. In particular, the information stored offshore remains accessible by the Commissioner.
48. There are inherent risks to accessing information stored offshore as New Zealand laws may not apply to information that is physically stored in another jurisdiction (electronically or otherwise). The Commissioner must rely on the cooperation of customers or third parties to access information stored offshore. Furthermore, the Commissioner's access could be jeopardised if the third party who is providing the storage services has no presence in New Zealand.
49. Therefore, in order to ensure the records held offshore by a third party remain accessible, the Commissioner will have regard to the following when considering an application by a third party:
    - whether the third party has a place of business in New Zealand or carries on its business through an establishment in New Zealand; and
    - how the clients' data will be dealt with should the third party no longer hold records for clients or for a particular client (for example, the contractual relationship ends between a client and the third party or the third party ceases to exist).
50. Each application will be considered on the merits of the case and may include the compliance history of the applicant.
51. In terms of an authorisation to a third party, s 22(8)(b) provides that in addition to the Commissioner authorising the third party to hold records for customers outside New Zealand, the Commissioner also has the discretion to require the records to be kept in a particular form and to be accessible in a way approved by the Commissioner. The need to impose such terms on an authorisation to a third party will depend on the circumstances of the third party and will be considered on a case by case basis.
52. An application to store records offshore should address the above factors. If the storage of records offshore is by electronic means, the applicant may be required to provide information that demonstrates the manner in which the records are to be stored will meet the requirements of the CCLA and CCLETR as discussed in [24] to [37] above. The information supplied in support of the application may include the following:
    - documentation that describes the operation of the systems in which the records are stored;
    - explanation as to how the records are stored offshore and how they can be accessed by the Commissioner should it be required;
    - standard terms and conditions for services of data storage provided by the third party to their customers;
    - any Code of Practice disclosure statements applicable to a third party. For example, the New Zealand code of practice for cloud computing which a New Zealand-based cloud provider can voluntarily adhere to. Certain information about the cloud provider and its services are disclosed under the code of practice.
53. The standard timeframe for processing third party applications is three months, dependent on the timely receipt of any further information requested.

Conditions of an authorisation

54. The Commissioner may impose conditions on an authorisation to store records offshore, as provided for in s 22(9).
55. All authorisations to store records offshore would be subject to the customer or third party providing an undertaking that the records would be provided to the Commissioner on request, in a usable format, and at no cost to Inland Revenue in obtaining the information. The undertaking would also require assurance that the records be provided in a timely manner and that extra time to respond to requests on the basis that the records are offshore would not be sought.
56. In order to ensure the information stored offshore continues to be accessible, the Commissioner may impose additional conditions that are considered necessary and reasonable in the circumstances of the case. As an example, to ensure that the Commissioner's access to information is not compromised where the relationship between the customer and a third party ends, a reasonable condition may be imposed by the Commissioner on the third party. This condition could be that at the end of the service agreement between the client and the third party, the third party will return the data to their client either in:
    - a format that is meaningful to the client; or
    - a format that can be readily exported into a meaningful format that the client can understand and can be used for subsequent reference.
57. Conditions may be varied as circumstances of the customer or the third party applicant change.

Withdrawal of authorisation

58. No period of validity would be prescribed on an authorisation. However, the Commissioner may withdraw an authorisation, either upon request by the customer or the third party to which the authorisation applies or by giving reasonable notice of the withdrawal. Circumstances where an authorisation may be withdrawn include:
    - non-compliance to the conditions of an authorisation or to an information request;
    - the customer or third party no longer keeps records offshore.

Public notice of an authorisation or withdrawal

59. A public notice of an authorisation given to a third party or the withdrawal of that authorisation will be published on Inland Revenue's website. **A list of authorised third party providers**[2] can also be found on the IRD Tax Technical website.

Customer has ultimate obligation

60. An authorisation given to a third party does not replace a customer's responsibility to meet the record keeping requirements as per the Inland Revenue Acts. The authorisation merely enables a customer to store records offshore without being in breach of their obligation to hold those records in New Zealand. A customer still has the responsibility to ensure that their records, whether stored in New Zealand or offshore (or both), are sufficient to satisfy their record keeping requirements.
61. Further, an authorisation to a third party should not be relied upon as an approval of the third party as a service provider in general. The individual customer should carry out their own assessment of the third party to ensure that they are satisfied that services offered meet the customer's business needs. The authorisation provided by the Commissioner merely relates to the offshore storage of records.

Providing information to Inland Revenue

62. The Commissioner can request information from any person pursuant to s 17B. Any person, when required under s 17B, must produce for inspection any documents that the Commissioner considers necessary or relevant for a purpose under an Inland Revenue Act. The failure to produce information that is in the person's knowledge, possession or control when requested, is an offence under the TAA.
63. A third party may be required to provide information that is in their possession when requested under s 17B. The request may include any logs of entries, alterations and deletions of transactions that a third party may keep.
64. Generally, a s 17B request will be made to the customer in the first instance. On occasion, the Commissioner may request this information from a third party. Factors that may influence the Commissioner's decision to request information from a third party include whether the documents required may be at risk, and where there has been non-compliance or non-cooperation with previous requests for information.

[2] **www.taxtechnical.ird.govt.nz/general-articles/third-party-providers-approved-to-store-taxpayer-electronic-records-offshore**

65. Section 17B notices (including those issued to a third party other than the customer) will be issued following the practice set out in OS 13/02 Section 17[3] notices (or any subsequent replacements of that OS). Also refer to SPS 10/02 Imaging of electronic storage media for the Commissioner's standard practice for imaging of electronic information when exercising the information gathering powers now contained in s17 B.
66. Inland Revenue has officers that specialise in downloading electronically stored information. The preferred media for receiving electronic information is on CD, DVD or USB drive. However, other mutually agreeable transfer methods may be negotiated as required.
67. Electronic information supplied to Inland Revenue should be in a tab or comma delimited or fixed record length format, in EBCDIC or ASCII. It should be encrypted or password protected with the password/passphrase or any other information required to access the information supplied to Inland Revenue separately. The electronic information should be copied to media, not a proprietary back up. Documentation should be supplied with the media showing the record layout, record length, and number of records.

Assistance to Inland Revenue Officers

68. Where necessary, adequate viewing and printing facilities should be made available free of charge to Inland Revenue officers. If requested, persons must locate selected records that have been stored and print any items selected, free of charge to Inland Revenue.
69. Someone must be available to explain the operation of their computer system to Inland Revenue officers. This is the case whether the system is owned and operated by the person or outsourced to a third party.

Non-disclosure of tax advice document and legal privilege

70. Sections 20 to 20G provide customers with the right to non-disclosure of documents that are tax advice documents or documents that are legally privileged. The Commissioner will follow the standard practice for protecting these customer rights when requesting information.
71. There is a possibility that information relating to a particular customer obtained from a third party may contain documents that may be subject to these non-disclosure rights. Where a request for information is made to a person other than the customer pursuant to s 17B, the recipient of the request may contact the customer to confirm whether the customer wishes to claim non-disclosure right for tax advice documents or legal privilege over documents required to be disclosed. This is outlined in OS 13/02 Section 17[4] notices.
72. The Commissioner will attempt to deal with the claim of legal privilege or tax advice status of information with the person making the claim. If the claim of legal privilege or the non-disclosure of tax advice documents cannot be resolved between the Commissioner and the person making the claim, the Commissioner may apply to a District Court Judge for orders under s 20(5) as to whether the claim for legal privilege is valid or under s 20G as to whether the document is a tax advice document.
73. Refer to OS 18/02 Non-disclosure right for tax advice documents (or any subsequent replacements of that OS) for more information on what constitutes tax advice documents and the process for claiming non-disclosure right for these documents.

The Commissioner's discretion to authorise records being kept in a language other than English or te reo Māori

74. Sections 22, 26 (records to be kept for resident withholding tax purposes) and s 32 (records of specified charitable, benevolent, philanthropic, or cultural bodies) and s 75 of the GSTA require customers to keep sufficient records in the English or te reo Māori languages to enable the Commissioner to readily ascertain the customer's liability to tax.
75. The reason for the requirement to keep records in English or te reo Māori is that these are New Zealand's two official written languages. However, Inland Revenue recognises that the choice of language for business dealings is not a matter for the Commissioner to determine. It may be reasonable for a person whose business is conducted in a language other than English or te reo Māori (alternative language) to have Inland Revenue accommodate their language preference.
76. Each of ss 22, 26 and 32 and s 75 of the GSTA provides discretion to the Commissioner to allow records to be kept in an alternative language, following an application. Therefore, those customers who wish to keep their records in an alternative language must apply to the Commissioner to do so.

[3] Section 17B was previously s 17 until amended by the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019.

[4] Section 17B was previously s 17 until amended by the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019.

77. The tax law obligations of other parties, such as the recipient of a tax invoice, must also be considered. When base records, such as invoices and receipts, are maintained in an alternative language there may be some inconvenience to other persons. GST tax invoices and debit and credit notes raise a specific issue. They are necessary for ascertaining the tax liability of the issuer and of that other party. Therefore, they are records covered by s 75(3) of the GSTA that must be maintained in English, unless the Commissioner gives permission to use another language.
78. There are explicit requirements under ss 24, 24BA and 25 of the GSTA for specific English phrases to be used in a GST tax invoice or debit and credit notes. These phrases are:
    - tax invoice;
    - copy only – on copy of lost tax invoice, credit or debit note;
    - buyer created tax invoice – IRD approved;
    - modified tax invoice – IRD approved; and
    - credit note or debit note – on credit or debit notes.
79. There is no discretion to allow the use of expressions in an alternative language to satisfy the requirements imposed in ss 24, 24BA and 25 of the GSTA.

The Commissioner's standard practice

80. A person may apply to keep records (i.e., invoices, receipts, cash books, and journals) in an alternative language for tax purposes. The application should specify which records the customer wishes to keep in an alternative language.
81. A customer may seek approval to keep only some of their records in an alternative language. In addition, where approval to keep certain records in an alternative language has been obtained, there is nothing to stop a person continuing to keep all or some of those records in English or te reo Māori. This would extend to having an individual document completed partly in an alternative language and partly in English or te reo Māori.

The Commissioner's Consideration

82. The Commissioner will generally approve applications to keep records in an alternative language where a case can be demonstrated, provided that:
    - the customer complies with the requirements of ss 24, 24BA and 25 of the GSTA; and
    - numbers are recorded using Arabic numerals (i.e., 0, 1, 2, 3, 4, 5, 6, 7, 8, and 9) in order to accommodate the needs of other parties.
83. In any case, the customer's records must be sufficient to allow the Commissioner to readily ascertain the customer's tax liabilities.
84. The approval is not a relaxation in the standard of record keeping as required by the Inland Revenue Acts. Nor does the approval necessarily mean Inland Revenue will communicate with customers in that alternative language.

Impact on other parties

85. A recipient of a record that has been completed in an alternative language, such as an invoice or receipt that will be used by that other party to ascertain their tax liability, does not need to also apply for approval to keep records in an alternative language. The balance of commercial convenience between buyers and sellers will determine what language is used in any particular case.

Returns not to be completed in alternative language

86. The law is silent on the language to be used in completing any returns that a person may be required to provide to the Commissioner. The Commissioner will accept returns in the prescribed format, completed in either the English or te reo Māori language with numbers entered using Arabic numerals.

This Standard Practice Statement is signed on 6 May 2021.

Rob Falk
National Advisor, Technical Standards - Legal Services

Legislative references

Tax Administration Act 1994

Section 22 Keeping of business and other records

Contract and Commercial Law Act 2017

Section 229 Legal requirement to retain document or information that is in paper or other non-electronic form

Section 231 Extra conditions for electronic communications

Contract and Commercial Law (Electronic Transactions) Regulations 2017

Schedule 2 Prescribed conditions in order to meet legal requirements by electronic means

LEGAL DECISIONS – CASE SUMMARIES

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

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

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

CSUM 21/06: Court orders the backdating of child support liability is invalid

Case	Lindsay v Commissioner of Inland Revenue [2021] NZHC 830
Decision date	20 April 2021
Legislative References	Child Support Act 1991 (as it applied in October 2003), ss 4, 14, 17, 18, 19 Judicial Review Procedure Act 2016, s 16. High Court Rules 2016, r 14.6.
Legal terms	Judicial review; Child support; Proof of paternity; Backdated child support liability; Court's discretion in granting judicial review; Increased costs.

Summary

This is a judicial review proceeding in which Mr Lindsay challenged the Commissioner of Inland Revenue's ("the Commissioner") decision requiring him to pay child support dating back to 2003.

Cooke J upheld Mr Lindsay's judicial review challenge, making a declaration that the child support assessment of the Commissioner dated 23 November 2017 is invalid to the extent that it imposed backdated liability to 2003.

Cooke J also awarded scale costs against the Commissioner with an uplift of 10%.

Impact

Whilst the outcome of this case turned on its facts, the judgment is significant as it is the first time that a New Zealand Court has had to consider the interpretation of s 19 of the Child Support Act 1991 ("the CSA").

Facts

Mr Lindsay met Ms Jones in around 1994. (These are not the parties true names. Under the inherent jurisdiction there are orders prohibiting the publication of the identity of Mr Lindsay, Ms Jones and their child.) They began a sexual relationship in 1999 or 2000 when Mr Lindsay was a single parent. The sexual relationship ended in December 2002.

Ms Jones rang Mr Lindsay in March 2003 to tell him that she was pregnant and that he was the father. Ms Jones gave birth to their son in September 2003.

In 2016, Mr Lindsay was served with paternity proceedings by Ms Jones. He defended the proceedings on the basis that he could not be sure that he was the father but agreed to do DNA testing. This testing established that he was the father and a paternity order was made by the Family Court on 26 October 2017. Ms Jones also applied for child support at this time.

On 27 November 2017 the Commissioner determined that Mr Lindsay was obliged to provide child support. His child support liability was backdated to 2003, the time when Ms Jones first made an application for child support. The backdated amount owing by Mr Lindsay was around $89,000.

Issues

The issues that Cooke J were required to determine are:

- Which version of s 19 of the CSA is applicable; the section as it applied in 2003 (when the application was first made) or the one that applied when the Commissioner made the assessment in 2017;
- Whether other matters, such as the lack of a birth certificate and IRD number for the child, prevented s 19 from applying;
- Whether s 19 applied to the 2003 application;
- Whether the Court should nevertheless decline relief even if Mr Lindsay were able to persuade the Court that the Commissioner had misinterpreted the legislation; and
- Whether the Commissioner was liable for indemnity costs pursuant to r 14.6(4) of the High Court Rules.

Decision

Which version of s 19 of the CSA is applicable

Cooke J determined that Parliament provided that child support for the financial years before the amended legislation came into effect were to be assessed under the legislation prior to amendment as provided for in transitional provisions. Cooke J held that the words "financial support" clearly refer to "child support", which includes backdated child support since s 19 is part of the child support regime. (The provisions concerning child support applications are within cl 1A(1) of the Child Support Amendment Act 2013.)

Whether the other matters prevented s 19 from applying

Cooke J agreed with the Commissioner's submission that the two additional matters (lack of birth certificate and IRD number) did not prevent s 19 from operating. Cooke J held that both were routine matters that would be expected to be addressed had the application for child support been pursued. The key issue for s 19 purposes was the lack of evidence of parenthood.

Whether s 19 applied to the 2003 application

Cooke J held that the application in 2017 was correctly treated as a new application rather than a continuation of the one made in 2003. Cooke J specifically accepted Mr Lindsay's argument that the application filed in 2003 was refused and that Ms Jones subsequently confirmed it was not pursued.

Cooke J determined that s 19 had no application, for the following two reasons:

- This was not a situation where the Commissioner was "unable to accept" Ms Jones' 2003 application for lack of evidence of parenthood. Rather, Ms Jones' application was declined at that time. This was because Ms Jones had advised that she was not pursuing the procedures referred to in s 19 to establish parenthood, and she received reduced social welfare as a consequence; and
- In 2006, Ms Jones advised the Commissioner that she was no longer receiving any social welfare for the child or pursuing any child support application. From this point her application was no longer alive, including for the purpose of s 19.

Whether the Court should exercise its discretion to decline relief

The Commissioner submitted that the Court should not exercise its discretion for the following two reasons:

- Since Mr Lindsay had a right of appeal which he had not exercised, judicial review relief should not be made available to him; and
- In all the circumstances of the case relief should be declined.

Mr Lindsay should have pursued appeal rights

Cooke J saw no substance in the Commissioner's argument. His Honour held that the right to challenge decisions by way of judicial review is a fundamental right that is affirmed by s 27 of the New Zealand Bill of Rights Act 1990. Cooke J held that this right exists irrespective of whether there is a right of appeal, which is expressly confirmed by s 16(3)(a) of the Judicial Review Procedure Act 2016.

In addition, his Honour considered objection or appeal rights would not have been the most appropriate avenue because the present case was one best suited for judicial review since it turned on questions of statutory interpretation.

Finally, whilst there was some delay in the present case it was not such that would warrant a Court declining relief in its discretion for that reason.

Other discretionary factors

Cooke J had no hesitation in rejecting the other arguments advanced by the Commissioner. His Honour held that there was real difficulty with the proposition that the Court should, in its discretion, decline to set aside a determination that someone is liable to pay the Crown approximately $90,000 notwithstanding concluding that that amount was not lawfully due.

To the extent that it was appropriate to consider what is before Parliament by way of a Bill, Cooke J noted that it is noteworthy that the Child Support Bill 2020 recognises the unfairness in long periods of backdating. However, his Honour considered that the proposals did not remedy the more extreme circumstances such as the present case.

Whether the Commissioner was liable for indemnity costs

Cooke J held that the high threshold required for indemnity costs to be awarded was not met in this case. However, Cooke J considered that increased costs under r 14.6(3)(c) could be awarded if a proceeding is of importance to persons other than the parties and it is reasonably necessary for the party claiming costs to bring the proceeding in the interests of those affected.

Cooke J held that Mr Lindsay met both requirements and accordingly awarded an uplift of 10% in scale costs on a 2B basis.

About this document

These are brief case summaries, prepared by Inland Revenue, of decisions made by the Taxation Review Authority, the District Court, the High Court, the Court of Appeal or the Supreme Court in matters involving the Revenue Acts. For Taxation Review Authority matters, names have been anonymized. The findings of the court described in a case summary will no longer represent current law where the matter has been successfully appealed or subsequent amended legislation has been enacted.

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

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