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Inland Revenue
Te Tari Taake

ISSN 1177-620X (Online)

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

Your opportunity to comment

Ref	Draft type	Title	Comment deadline
PUB00480	Interpretation statement	Income tax – Overdrawn shareholder loan account balances	2 August 2024
PUB00274	Interpretation statement	Income tax – identifying the relevant item of property for depreciation purposes	29 August 2024

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NEW LEGISLATION

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

Taxation (Budget Measures) Act 2024

Overview

The Taxation (Budget Measures) Act 2024 was introduced on 30 May 2024. It received its first reading on 30 May 2024, its second reading on 30 May 2024 and its third reading on 30 May 2024. The new Act received Royal assent on 4 June 2024.

It amends the:

- Income Tax Act 2007
- Tax Administration Act 1994, and
- Student Loans Scheme Act 2011.

Legislative amendments:

- Personal income tax
- Independent earner tax credit
- In-work tax credit
- Minimum family tax credit
- FamilyBoost
- R&D Tax Incentive: Filing under incorrect entity name
- Student loan scheme base interest rate

Personal income tax

Sections GB 27(2), RD 10(2), RD 17 (2) and (4), RD 50(2) and (3), and schedules 1, 2 and 6 of the Income Tax Act 2007

Schedules 5 and 8 of the Tax Administration Act 1994

Amendments that increased the three personal income tax thresholds took effect on 31 July 2024. These changes reduce the amount of tax a person is required to pay on their personal income.

Consequential changes to other tax types that are based on personal tax rates and thresholds will mostly take effect from 1 April 2025, with resident withholding tax (RWT) taking effect from 31 July 2024.

Key features

The Taxation (Budget Measures) Act 2024 enacted changes to the personal income tax thresholds. The previous and new thresholds are set out below:

Previous threshold	New threshold	Threshold rate
$0 – $14,000	$0 – $15,600	10.5%
$14,001 – $48,000	$15,601 – $53,500	17.5%
$48,001 – $70,000	$53,501 – $78,100	30%
$70,001 – $180,000	$78,101 – $180,000	33%
$180,001+	$180,001+ (No change)	39%

Changes to the new thresholds took effect on 31 July 2024. To give effect to the part-year change, composite personal income tax thresholds and rates have been put in place for the full tax year (1 April 2024 to 31 March 2025).

There are also a number of consequential changes for tax types that are based on personal income tax rates and thresholds. Examples of tax types which require consequential changes include RWT, FBT, employer superannuation contribution tax, retirement scheme contribution tax and the prescribed investor rates.

Effective date

The changes have three effective dates.

- 1 April 2024 for:
  - formula to calculate fringe benefit tax (FBT)
  - composite personal income tax rates and thresholds.
- 31 July 2024:
  - resident withholding tax (RWT)
  - certain tax codes and rates
  - reporting of information by individuals and treatment of certain amounts.
- 1 April 2025 for:
  - attribution rule for income from personal services
  - amounts of tax for PAYE income payments
  - payment of extra pay with other PAYE income payments
  - personal income tax, FBT and employer superannuation contribution tax rates and thresholds
  - basic tax rates for PAYE income payments
  - prescribed investor rate.

NEW LEGISLATION

Detailed analysis

Changes effected from 1 April 2024

Composite rates

The new tax thresholds came into effect on 31 July 2024. This means for PAYE, the previous tax thresholds apply for the first three months and 30 days of the 2024–25 tax year, and the new thresholds apply for the remaining eight months and one day of the tax year.

New Zealand's PAYE system is very accurate at withholding the correct amount of tax through the year. However, because the thresholds changed part-way through the year, two sets of thresholds will be applicable in a single tax year and there is a risk that people will pay too much or too little tax. To try to mitigate this, a weighted average of the new and old rates will be applied across the entire tax year to determine a person's annual tax liability. This is a composite rate.

These composite rates and thresholds are used for end of year tax calculations such as Inland Revenue's end-of-year "square-up" calculations, which assess a taxpayer's income against the amount of tax paid over that income year (and may still result in a tax refund or liability).

The composite rates and thresholds applicable from 1 April 2024 for the 2024–25 tax year are:

Composite tax thresholds	Composite tax rates
0 – $14,000	10.5%
$14,001 – $15,600	12.82%
$15,601 – $48,000	17.5%
$48,001 – $53,500	21.64%
$53,501 – $70,000	30%
$70,001 – $78,100	30.99%
$78,101 – $180,000	33%
$180,001+	39%

Example 1: Tax liability for the 2024–25 tax year using composite rates and thresholds

Manraj earns $75,000 in the 2024–25 tax year.

Manraj's tax liability for the tax year will be calculated using the composite rates and thresholds, which would mean:

- the first $14,000 will be taxed at 10.5%
- every dollar earned between $14,001 and $15,600 will be taxed at 12.82%
- every dollar earned between $15,601 and $48,000 will be taxed at 17.5%,
- every dollar earned between $48,001 and $53,500 will be taxed at 21.64%,
- every dollar earned between $53,501 and $70,000 will be taxed at 30%, and
- every dollar earned after $70,001 until $75,000 will be taxed at 30.99%.

Changes to FBT calculation for the attribution method

The previous formula is designed to calculate the FBT payable assuming personal income tax and FBT rates are essentially the same. However, because the changes to the personal income tax and FBT thresholds become effective at different dates, the previous formula would have resulted in an amount of FBT payable that effectively claws back the tax relief the new personal income tax thresholds provide for the 2024–25 tax year.

The new formula prevents this. The formula is:

Tax on all-inclusive pay – FBT on net cash pay.

Where:

- all-inclusive pay is the sum of net cash pay and the value of taxable fringe benefits received by the employee
- net cash pay is the cash left in hand of the employee after tax, ie:

cash pay – tax on cash pay.

Example 2: Tax liability for the 2024–25 tax year using composite rates and thresholds

Abby earns a salary of $14,000 and receives a fringe benefit that has a taxable value of $10,000 in the 2024–25 tax year.

Abby's employer's FBT liability for the tax year using the new formula will be:

$3,590.77 – $1,469.77 = $2,121.00

Where:

- $12,530 is the net cash pay, ie, salary less the personal income tax payable on the salary $14,000 – ($14,000 x 10.5%) = $12,530
- $3,590.77 is the tax on all-inclusive pay, ie, amount of FBT payable on the sum of the net cash pay ($12,530) and value of the fringe benefit ($10,000), and
- $1,469.77 is the FBT payable on net cash pay ($12,530).

Changes effected from 31 July 2024

Changes to RWT

The changes to RWT took effect from 31 July 2024 alongside the personal income tax threshold changes. Because interest and dividends are included in a taxpayer's personal income tax calculation at the end of the year, RWT rates do not change. However, people will be able to elect the 10.5% rate if they expect their total income to be less than the lowest personal income tax threshold of $15,600.

Some customers who have elected higher RWT rates are likely to advise payers of resident withholding income that they wish to change their elected tax rates following the increases to the personal income tax thresholds. The limited changes to RWT are not expected to require payers of resident withholding income to make major changes.

Changes effective from 1 April 2025

Personal income tax thresholds

The increased personal tax thresholds will already be in place at the start of the 2025-26 income year. This means the personal income tax rates and thresholds applying from 1 April 2025 will be:

Tax thresholds	Tax rates
0 – $15,600	10.5%
$15,601 – $53,500	17.5%
$53,501 – $78,100	30%
$78,101 – $180,000	33%
$180,001+	39%

Consequential tax types

Most consequential changes to other tax types will also apply from 1 April 2025. This involves changes to the thresholds of:

- FBT
- employer superannuation contribution tax
- retirement scheme contribution tax
- prescribed investor rate, and
- other sections of the Income Tax Act 2007 and Tax Administration Act 1994 that reference the old personal income tax thresholds.

Most of these tax types will have references to old personal income tax thresholds replaced with the new thresholds except for FBT and employer superannuation contribution tax.

Fringe benefit tax thresholds

Thresholds of FBT are determined by the net in-hand income, ie, the difference between the gross income and the personal tax payable. The new FBT thresholds are set out below.

Range of dollar in all-inclusive pay	Tax rate
$0 – $13,962	11.73%
$13,963 – $45,230	21.21%
$45,231 – $62,450	42.86%
$62,451 – $130,723	49.25%
$130,724+	63.93%

Employer superannuation contribution tax thresholds

The thresholds of the employer superannuation contribution tax are 20% greater than the personal income tax thresholds. The new ESCT thresholds are set out below.

Employer superannuation contribution tax threshold amount	Tax rate
$0 – $18,720	10.5%
$18,721 – $64,200	17.5%
$64,201 – $93,720	30%
$93,721 – $216,000	33%
$216,001+	39%

Independent Earner Tax Credit

Sections LC 13, LC 14 and LC 15 of the Income Tax Act 2007

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

The amendments change the independent earner tax credit (IETC) settings so the credit begins abating at $66,000 and fully abates at $70,000. This ensures that people can continue to receive IETC at higher income levels.

Background

Previously, a taxpayer was entitled to the IETC if they earned between $24,000 and $48,000 per year, at a maximum amount of $520 per year ($10 per week). They received the maximum IETC available when they earned between $24,000 and $44,000 per tax year, their IETC entitlement reduced when they earned more than $44,000 per tax year and they became ineligible once they earned more than $48,000.

The changes increased the threshold where abatement begins and the threshold where taxpayers are no longer eligible to receive the IETC. The maximum amount receivable continues to be $520 per year ($10 per week).

The previous and new settings are set out below.

	Eligibility starts	Abatement	No longer eligible
Previous	$24,000	Entitlement abates by 13 cents per dollar earned over $44,000	$48,000
New	$24,000 (no change)	Entitlement abates by 13 cents per dollar earned over $66,000	$70,000

However, even if a taxpayer earns within the income thresholds, they become ineligible for any months in which they receive a main benefit, student allowance, New Zealand superannuation or veteran's pension or are eligible to receive Working for Families tax credits.

Effective date

The amendments came into effect on 31 July 2024.

Detailed analysis

Composite calculation for the 2024–25 tax year only

The previous IETC settings apply for the first three months and 30 days of the 2024–25 tax year, and the new settings apply for the remaining eight months and a day of the tax year.

A composite calculation is provided to calculate a taxpayer's full year entitlement to account for two sets of IETC settings being applicable in one year.

For 1 April 2024 to 30 July 2024, the IETC entitlement is calculated using the formula:

(person's credit – full year abatement) x credit period days ÷ 365.

Where:

- **a person's credit** is either $520 if the taxpayer's net income for the tax year is equal to or more than $24,000, but $0 if the net income is less than $24,000 or more than $48,000
- **full year abatement** is the total of 13 cents per dollar earned over $44,000 for the tax year
- **credit period days** is the number of whole days in the period 1 April 2024 to 30 July 2024.

For 31 July 2024 to 31 March 2025, the IETC entitlement is calculated using the formula:

(person's credit – full year abatement) x credit period days ÷ 365.

Where:

- **a person's credit** is either $520 if the taxpayer's net income for the tax year is equal to or more than $24,000, but $0 if the net income is less than $24,000 or more than $70,000
- **full year abatement** is the total of 13 cents per dollar earned over $66,000 for the tax year
- **credit period days** is the number of whole days in the period 31 July 2024 to 31 March 2025.

1. Therefore, the calculation for the 2024–25 tax year is:

Period 1		Period 2		
((($P – X) x 121/365)	+	(($P – Y) x244/365))	x	EM/12.

Where:

- **Period 1** refers to the period 1 April 2024 to 30 July 2024 when the previous settings apply, and **Period 2** refers to when the new settings apply (31 July 2024 to 31 March 2025)
- **$P** = either $520 if the taxpayer's but less than the maximum threshold of the applicable setting, or $0 if the taxpayer earns less than $24,000 or more than the maximum threshold of the applicable setting
- **X** = amount of abatement under the old settings
- **Y** = amount of abatement under the new settings
- **EM** = number of full months the taxpayer was not ineligible for the IETC due to receiving a main benefit, student allowance, New Zealand superannuation or veteran's pension or being eligible to receive Working for Families.

Eligible months continue to be determined on an annual basis. This means that the total combined IETC amount from periods 1 and 2 are then multiplied by the number of eligible months divided by 12.

Example 1: Annual IETC entitlement using composite calculation for the 2024-25 tax year

Elizabeth earns $45,000 in the 2024–25 tax year.

Elizabeth is entitled to IETC because she receives no main benefit or government support and earns more than $24,000 but less than the maximum thresholds of both the previous and new settings – $48,000 and $70,000. Elizabeth's $45,000 annual income is $1,000 above the beginning of the abatement zone for the period up to 30 July 2024.

Elizabeth's IETC entitlement for the tax year will be calculated using the composite calculation, which would mean:

((($520 - $130) x 121/365) + (($520 – 0) x 244/365)) x 12/12 = $476.90.

Where:

- $130 is the amount of the abatement under the settings applicable for 1 April 2024 to 30 July 2024 (13 cents x $1,000)
- 121 is the number of days the settings applicable for 1 April 2024 to 30 July 2024 apply
- $0 is the amount of the abatement under the settings applicable for 31 July 2024 to 31 March 2025 (13 cents x $0)
- 244 is the number of days the settings applicable for 31 July 2024 to 31 March 2025 apply
- 12 is the number of whole months Elizabeth was eligible for IETC.

In-work tax credit

Sections MD 10, MF 4J and MF 4K of the Income Tax Act 2007

The amendment increases the in-work tax credit (IWTC) base rate by $25 per week.

Background

The IWTC is the key instrument to "make work pay" within the wider context of the Working for Families package. It supports low- to middle-income working families whose members take up and stay in employment, rather than remaining on a benefit. It achieves this by providing a boost to the family's income once members begin working.

There is no requirement to automatically increase the rate of IWTC over time. The real value of the IWTC had decreased relative to wage growth, and its effectiveness as an incentive to move off a benefit and to take up and stay in employment had lessened.

Effective date

The new IWTC rate came into effect on 31 July 2024.

The part-year amendments, which allow the old rate and the new rate to be used for different periods in the 2024–25 tax year, apply from 1 April 2024 to 30 July 2024.

Detailed analysis

The IWTC base rate has been increased from $3,770 per year to $5,070 per year. This represents a $25 increase in weekly income.

The maximum weekly entitlement for a family of up to three children has increased from $72.50 to $97.50.

The additional child rate remains at $15 more per week.

Working for Families is an annual entitlement that is paid on a tax year basis. Sections MF 4J and MF 4K introduce a method to allow the old rate and new rate to be used for different periods in the 2024–25 tax year. The previous IWTC amount of $3,770 will be used to calculate IWTC entitlements until 30 July 2024.

Example: IWTC entitlements following this amendment

Mele and Greg have three children. Mele works full time at the local apothecary, while Greg works part time and looks after the children.

The family receives Working for Families to help cover the cost of raising their children, including the full amount of IWTC.

From 1 April 2024 to 30 July 2024, Mele and Greg received $72.50 of IWTC per week. From 31 July 2024 onwards, Mele and Greg will receive $97.50 of IWTC per week.

At the end of year square-up, the old IWTC rate will be used to calculate correct entitlements from 1 April to 30 July. The new IWTC rate will be used to calculate the correct entitlements for the remainder of the 2024–25 tax year. As a result, their correct yearly IWTC entitlement for the 2024–25 tax year is $4,645.

Minimum family tax credit

Sections ME 1, MF 4J and MF 4K of the Income Tax Act 2007

The amendment adjusts the minimum family tax credit (MFTC) threshold to $35,316 after tax. This ensures that MFTC recipients benefit from the personal income tax changes and the increase to the IWTC.

Background

The MFTC is one of the Working for Families tax credits. Its purpose is to incentivise people at the margin with dependent children to move off the benefit and into full-time work. The MFTC achieves this by "topping up" the incomes of working families to an amount that is more than what they could potentially receive on a benefit.

The IWTC and the MFTC work together to top up a person's income to ensure that they are financially better off in work without a main benefit. The change made to the IWTC will automatically flow through to MFTC recipients by keeping the MFTC threshold at its current level.

However, for every dollar a family earns over the MFTC threshold, their MFTC entitlement reduces by a dollar. As such, the MFTC threshold has been increased to ensure that a family's entitlement is not reduced by reason of them gaining tax relief from the personal income tax rate changes.

Effective date

The new threshold came into effect on 31 July 2024.

The part-year amendments, which allow the old threshold and new threshold to be applied to calculate entitlements for different periods in the 2024–25 tax year, apply from 1 April 2024.

Detailed analysis

The MFTC threshold has been increased from $35,204 per year (after tax) to $35,316 per year (after tax). This represents a $2.15 increase in weekly income.

This change, in conjunction with the increase to the IWTC, will increase a recipient's income by approximately $27.15 per week.

Working for Families is an annual entitlement that is paid on a tax year basis. Sections MF 4J and MF 4K introduce a method to allow the old threshold and new threshold to be applied for the payment of instalments for different periods in the 2024–25 tax year. The previous MFTC amount of $35,204 will be used to calculate MFTC entitlements until 30 July 2024.

Example: MFTC entitlements following this amendment

Julia is a sole parent, who has a 6-year-old called Johnny. She works 20 hours a week on minimum wage and earns $400.82 per week after tax. She also receives Working for Families, including the MFTC.

From 1 April 2024 to 30 July 2024, Julia's after-tax income was topped up by $276.18 of MFTC per week. From 31 July 2024 onwards, Julia's after-tax income will increase to $402.97 per week and she will continue to be topped up by $276.18 of MFTC per week.

At the end of year square-up, the old MFTC threshold will be used to calculate Julia's correct entitlements from 1 April to 30 July. The new MFTC threshold will be used to calculate Julia's correct entitlements for the remainder of the 2024–25 tax year. As a result, Julia's correct yearly MFTC entitlement for the 2024–25 tax year is approximately $14,361.36.

FamilyBoost

Sections GB 44B, LA 7(1)(aba), LB 4BA, MA 1(ab), MA 6(2), RM 10(5), YA 1 and subpart MH of the Income Tax Act 2007

Sections 41C, 157(10)(m), 165A(2), 173L(2)(bc), 184A(5)(bb), 185(1)(eb) and schedule 7, part C, subpart 2, clause 46B of the Tax Administration Act 1994

A new payment named FamilyBoost has been created to support low- to middle-income families with the rising cost of living by providing targeted financial assistance to families with early childhood education (ECE) costs.

FamilyBoost is a "refund style" payment, calculated and paid quarterly after ECE fees have been incurred. This approach ensures that FamilyBoost payments contribute to actual ECE costs. The payment is targeted based on the combined incomes of the applicant and their partner, with payments abating completely at the equivalent of $180,000 a year ($45,000 a quarter). Payments are also capped per quarter at a maximum of $975.

Key Features

After the end of a quarter, FamilyBoost applicants are able to claim a tax credit of 25% of the ECE fees incurred in that quarter, up to a maximum payment of $975. The maximum payment abates where the quarterly income of the household is between $35,000 to $45,000, with no remaining entitlement at $45,000 and above.

New subpart MH of the Income Tax Act 2007 (ITA) and section 41C of the Tax Administration Act 1994 (TAA) introduce and outline the FamilyBoost tax credit, the credit's eligibility criteria, how the credit is calculated, and the process for claimants to apply for the credit.

Supporting provisions in the ITA and the TAA have also been amended to align FamilyBoost legislation with general tax legislation and to include administrative provisions that manage avoidance, debt, penalties, credit offsets and payments.

While the FamilyBoost tax credit will generally be referred to as a payment or as FamilyBoost in external communications, in legislation it is a new tax credit under subpart MH of the ITA. The subpart includes the eligibility criteria for the tax credit, calculation basis for the tax credit, and defines tax credit income and definitions associated with caregivers and ECE services. Consequential amendments have also been made to the administration and avoidance provisions in the ITA and TAA.

A household may be eligible where:

- a parent or caregiver and their partner (that is, spouse, civil union partner, or de facto partner) if relevant, are responsible for the day-to-day care of a child under six, other than on a temporary basis
- the household pays early childhood education fees for that child to a licensed early childhood education provider
- the household income is under $45,000 per quarter.

The key features are:

- Separated parents can submit separate applications for FamilyBoost, provided they each care for the child and meet some ECE costs directly.
- Parents and caregivers will apply in the manner specified by the Commissioner of Inland Revenue and provide the information required for the new tax credit. In practice, the parent or caregiver will apply though the myIR portal providing their family details and evidence of ECE fees.
- The FamilyBoost payment will be 25% of ECE costs payable by the person after existing support that reduces the fees payable is taken into account, such as Work and Income's childcare subsidy.
- Parents and caregivers can apply for a payment relating to a previous quarter but must apply within the four-year period after the end of the quarter that the application relates to.
- Where debt is generated, FamilyBoost will use the existing debt regimes that are used for other tax products.
- An information exchange with the Ministry of Education is provided for.

Effective date

The amendments came into effect on 1 July 2024.

Applicants will be able to claim FamilyBoost from 1 October 2024 for ECE costs incurred on or after 1 July 2024.

Detailed analysis

Eligibility

A parent or caregiver is entitled to a quarterly FamilyBoost tax credit if their household income does not exceed $45,000 and they meet the following eligibility requirements at some point during the quarter:

- have a child in their day-to-day care who is enrolled with a licensed early childhood service
- incur ECE fees for that child, and
- are tax resident in New Zealand.

FamilyBoost is paid per household rather than per person or per child, meaning the income and payment caps apply regardless of the number of children in the household attending ECE. If a parent or caregiver has already applied for FamilyBoost, their partner in that same household will not also be able to apply. Parents or caregivers can apply for FamilyBoost for invoices made out in their own name or their partner's name.

Separated parents and other caregivers

Where the parents of a child are separated at the end of a quarter and share the care of a child, FamilyBoost can be claimed by both parents provided they both have an ongoing responsibility for the day-to-day care of the child they are applying for, and both directly incur ECE fees for that child. Each parent must incur at least a portion of the ECE costs directly and provide separate invoices made out in their own name. Each separated parent will be treated as having a separate household and will be able to claim up to the $975 household cap per quarter.

Where a grandparent or other caregiver directly incurs ECE fees for a child, they can claim FamilyBoost provided they have an ongoing responsibility for the day-to-day care of the child. FamilyBoost is not available if the care is only on a temporary basis.

If a parent or caregiver is eligible for FamilyBoost but dies before applying for FamilyBoost their estate will be able to claim it on their behalf.

Registration and application

FamilyBoost's legislative provisions provide that parents and caregivers applying for the payment must complete an application in the manner specified by the Commissioner and provide the required information to support the application.

In practice, this means a person will need to register for FamilyBoost through myIR. At registration, caregivers will need to provide information about their family details.

After the initial registration is completed, caregivers will be able to log on to myIR at the conclusion of each quarter to make an application. As part of the application, the caregiver will declare their current relationship status at the end of the quarter and provide the required evidence of fees incurred. This evidence may take the form of invoices or a three-monthly statement of fees for the quarter from their ECE service.

The "point-in-time" check of family circumstances is intended to result in most applicants' FamilyBoost payment being full and final and avoid the creation of debt (except in cases of fraud or significant error).

If the parent or caregiver (or their partner) is required to file a tax return as part of their usual tax obligations to Inland Revenue, this will need to be filed before a FamilyBoost application can be made.

Parents and caregivers can apply at any point within the four-year period that begins on the day immediately following the end of the quarter in which they have a FamilyBoost entitlement. As such, families can choose to apply less frequently than quarterly if they wish. For example, they could apply annually (covering four quarters). This may suit some people based on when they are required to file a return of income.

Evidence of costs incurred

Parents or caregivers will need to upload ECE invoices or similar evidence, such as a quarterly summary of fees payable from their ECE provider via myIR to support their application. The information required on the invoices to be eligible for FamilyBoost is determined by the Commissioner. The current requirements are:

- the name, service address, licence number and GST number (if applicable) of the ECE service
- the billpayer's full name (that is the person(s) named on the invoice as responsible to pay the fees, which should match the name of the caregiver or their partner as provided in the FamilyBoost registration details)
- the full names of enrolled children (which should match the names provided to the Ministry of Education for the child's enrolment)
- the invoice's issue date
- the period covered by the invoice
- the final amount charged (after accounting for discounts and subsidies).

Similar information is required for a quarterly statement, along with an indication that the statement is for the full quarter.

The information requirements for FamilyBoost do not override the requirements under the Goods and Services Tax Act 1985 for taxable supply information on an invoice for ECE services. Rather, it sets out additional information that is required specifically for assessing FamilyBoost applications.

The required information will be listed on an Inland Revenue website and may be updated over time as needed.

Calculation

Subpart MH outlines how the FamilyBoost payment is calculated for a parent or caregiver. The payment amount will be determined by the ECE fees incurred and the income of the caregiver and their partner.

Fees charged after other ECE supports

The amount of the payment will be 25% of fees payable after other supports such as 20 Hours ECE and Work and Income's childcare subsidy are taken into account. It is also after any discounts are provided, such as a sibling discount. Fees can include optional charges agreed to by the parent or caregiver but do not include any amount that is a donation.

Quarterly tax credit income and abatement calculation

Inland Revenue will assess the parent or caregiver's household income on a quarterly basis using the most recent income information held by Inland Revenue. Generally, this will be either three months' reportable income (such as wages and salary, interest, and dividends) for the period or the most recent tax return filed for that period or an earlier period (where there is other taxable income). Where a person has a mix of reportable and other income types, the greater amount will be used. For example, where a person has self-employed income for a prior tax year and has current period reportable income such as interest income, the greater amount will be used for their income calculation.

Example 1: Single parent on salary/wage income only

Kathleen earns $85,000 per year in wages and has one child aged 3 in ECE for 40 hours per week. Her child is eligible for the 20 Hours ECE, and she is charged for the remaining 20 hours, which costs her $250 per week. Kathleen's employer has reported that she has earned $21,250 for the period 1 July to 30 September and Kathleen uploads her invoice showing she has been invoiced $3,250 in ECE fees for the same period. Because her income is under the quarterly cap of $35,000, she will receive a payment of 25% of the fees.

She will be paid $812.50 as her quarterly FamilyBoost amount.

Where a household has two earners – one self-employed and the other earning only reportable income, Inland Revenue will calculate eligibility using the self-employed person's last filed tax return combined with the other person's reportable income.

NEW LEGISLATION

Example 2: One parent is a salary/wage earner, the other is self-employed

Dharmendra works full time for wages, earning $1,700 per week ($88,400 a year). His partner, Neisha, is self-employed, working roughly 30 hours per week for her carpentry business. Neisha's last income tax return was filed by 7 July 2024, for the 2023–24 tax year. For that period, she earned $50,000. They have two children, Samira (4) and Niam (2). The combined weekly daycare cost after discounts for both children is $531 per week. Due to their level of income, they are not eligible for a childcare subsidy from Work and Income.

Inland Revenue uses Dharmendra's gross wages paid between 1 July and 30 September 2024 of $22,100 as reported by his employer. Neisha's income for this quarter will be calculated as $12,500 ($50,000 / 4) based off her last filed tax return. Their combined income for the quarter is $34,600. The ECE invoices are in Dharmendra's name.

In September, Dharmendra registers for FamilyBoost via myIR. In October, Dharmendra logs onto the account and submits the first claim, confirming their family's details and including the invoices he's been saving since July, which show they've spent $6,903 on daycare in the last three months. The family's earnings for the quarter are under the quarterly threshold of $35,000, so the family receives $975 into their bank account.

Abatement

Households with up to $35,000 of income for a quarter will receive the full payment, that is, 25% of fees for the quarter up to a maximum of $975.

Where a household's quarterly income falls between $35,000 and $45,000, the maximum payment of $975 will abate by 9.75 cents per dollar of income over $35,000. Families would receive the lesser of:

- 25% of fees for the quarter, or
- $975 less the abatement amount.

Households earning $45,000 or more per quarter will not receive a payment.

Payment

The payment can be made every three months into the applicant's nominated bank account. A person can request that the payment be transferred to another tax type to satisfy a debt.

Reassessments, additional invoices and time-bar for applications

In most cases, a household's entitlement to FamilyBoost is full and final. Reassessments will not be performed if new income information becomes available. Inland Revenue will have the power to reassess applications where a change in the applicant's circumstances has resulted in a significant over or underpayment or an unduly harsh outcome; guidance around where this power may be used will be clarified in a determination.

Where an application has been made with at least one invoice, an assessment of the caregiver's maximum entitlement will be made, based on their income and family circumstances. Subsequent to this assessment, a caregiver would be able to upload further invoices for that same quarter until their maximum entitlement is reached. This would need to be done within four years of the end of the quarter of the FamilyBoost entitlement.

Example 3: Additional invoices

Andy applies for FamilyBoost in May 2025, for the period 1 January 2025 to 31 March 2025. During this time, she had moved ECE services. She uploads eight weeks' worth of invoices from her original daycare centre and submits the application. Inland Revenue assesses her application based on her income for the period, family details and submitted invoices. The refund amount is significantly below the maximum entitlement based on her income. Later, she finds the five weeks of invoices from her current centre for the period. In October 2025, she uploads these to myIR to add them to the January 2025 to April 2025 quarter and is refunded 25% of the fees on these five invoices (assuming the total remains below the maximum of $975 for the quarter).

FamilyBoost applications will also have a four-year time bar. Parents and caregivers must apply within the four-year period that begins on the day immediately following the end of the quarter they are applying for. For example, a parent claiming for the 1 July 2024 to 30 September 2024 period has until 1 October 2028 to apply for that quarter's FamilyBoost payment.

Debt

Debt could arise as a result of fraud or where the Commissioner reassesses a parent or caregiver's FamilyBoost application, for example, due to uncovering a genuine error which results in a significant overpayment. What constitutes a significant overpayment will be established in a published determination and have regard to the resources available to the Commissioner.

Where a debt is created, income tax penalty and interest rules will apply to any outstanding amount.

Where a caregiver is unable or unwilling to repay a debt, Inland Revenue will utilise standard debt collection process and powers to negotiate a payment plan, consider a write-off, or enforce payment depending on the individual's situation.

Integrity

Integrity checks will be completed as applications are made. Claims will be subject to verification both during the application process and retrospectively. The Commissioner can reassess an amount and create a debt where the refund has been paid as a result of a person knowingly providing altered, false, incomplete or misleading information. Anti-arrangement rules also apply.

Changes to information-sharing provisions

Information will be shared with the Ministry of Education for the purposes of administering FamilyBoost. The Ministry of Education holds the details of children who are in ECE and details around licensed ECE services, which will be used to verify that the child is enrolled with the ECE service that the parent is providing an invoice from, and that the service is licensed.

R&D Tax Incentive: Filing under incorrect entity name

Sections 33G, 68CB, and 68CC of the Tax Administration Act 1994

The amendments enable the Commissioner of Inland Revenue to amend an approval of a person enrolled in the Research and Development Tax Incentive (RDTI) in instances where the person has applied for approval using an incorrect entity name.

Background

For a person to be able to claim a tax credit through the RDTI regime, they must apply for approval (either a general approval of their activities or a criteria and methodologies approval) and then submit a supplementary return containing their research and development (R&D) expenditure for the year.

In a wholly-owned group situation, approval must be sought in the name of the entity undertaking the R&D. If, for example, approval was applied for and given to a parent company when its wholly-owned subsidiary company was the entity undertaking the R&D, then RDTI tax credits would not be processed for either entity if the time to vary that approval had elapsed.

Key features

- A person can apply to the Commissioner to amend the name of an entity in an RDTI approval if they have incorrectly named another entity within the same wholly-owned group in the approval.
- If a person has an application to amend a name in an RDTI approval accepted, they have 30 days to subsequently file a supplementary return in the correct entity's name.

Effective date

The amendments apply for the 2021–22 and later income years.

Student loan scheme base interest rate

Section 4 of the Student Loans Scheme Act 2011

The student loan scheme base interest rate has been increased by 1% for five years from 1 April 2025. This means that the interest rate charged on an overseas-based borrower's student loan increases by 1%, as does the late payment interest rate charged on unpaid amounts.

Background

The base interest rate is the interest charged on overseas-based borrowers' student loans. Late payment interest is charged on unpaid amounts and is the base interest rate plus 4%.

Inland Revenue determines the base interest rate using the five-year average of the ten-year bond rate to December in the year preceding the tax year to which the rate will apply (to two decimal places) plus a margin of 0.74%. This number is then rounded to the nearest decimal place.

The interest rate charged on overseas-based borrower loans was 2.9% for the 2023–24 tax year (and is 3.3% for 2024–25). Late payment interest charged on overdue student loan payments (for both New Zealand-based and overseas-based borrowers) was 6.9% for the 2023–24 tax year (and is 7.3% for 2024–25).

Over the last three years inflation has overtaken the base interest rate by 9.5%. The amendment increases the student loan base interest rate by 1% for five years to partially cover the loss in value of the student loan scheme due to three years of high inflation.

Effective date

The amendments apply for five years from 1 April 2025 to 1 April 2030.

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.

FDR 2024/02: A type of attributing interest in a foreign investment fund for which a person may not use the fair dividend rate method (Colchester Multi-Strategy Global Bond Fund PLC – The Colchester Global Green Bond Enhanced Currency Fund - NZD Hedged Accumulation Class Z Shares)

Any investment by a New Zealand resident investor in shares in The Colchester Global Green Bond Enhanced Currency Fund - NZD Hedged Accumulation Class Z Shares to which none of the exemptions in sections EX 29 to 43 of the Income Tax Act 2007 apply, is a type of attributing interest for which the investor may not use the fair dividend rate ("FDR") method to calculate foreign investment fund income for the interest.

Reference

This determination is made under section 91AAO(1)(b) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Technical Specialist under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Shares in the New Zealand Dollar (NZD) denominated class of The Colchester Global Green Bond Enhanced Currency Fund Share Class: NZD hedged Accumulation Class – Z Shares are an attributing interest in a foreign investment fund ("FIF") for New Zealand resident investors when none of the exemptions in section EX 29 to EX 43 of the Income Tax Act 2007 apply. The Fund is part of The Colchester Multi-Strategy Global Bond Fund PLC and incorporated under the laws of Ireland.

The Colchester Multi-Strategy Global Bond Fund PLC is structured as an umbrella fund with segregated liability between sub-funds. These sub-funds do not have a separate legal personality.

New Zealand resident investors are required to apply the FIF rules to determine their tax liability in respect of their investment in shares in the NZD denominated class of the Fund ("the NZD Share Class") each year.

The Fund invests in a broadly diversified portfolio of eligible intermediate term domestic and global fixed interest and money market securities. The Fund has various share classes denominated in different currencies, including USD, AUD, GBP, EUR and NZD that provide holders of those classes of shares with an interest in the pool of investments held by the Fund. The NZD class of shares of the Fund is denominated in New Zealand dollars. The Fund has foreign currency hedging arrangements in place which effectively provide investors in the NZD class of the Fund with a New Zealand dollar denominated return on the financial arrangements held by the Fund.

Section EX 46(10)(c) of the Income Tax Act 2007 would not apply to prevent the use of the FDR method for interests in the NZD Share class but would apply if the Fund represented a separate foreign company and the NZD Share Class was the only class of share on issue.

The policy intention is that the FDR method of calculating FIF income should not be applied to investments that provide a New Zealand resident investor with a return similar to a New Zealand dollar denominated debt investment. It is appropriate for the Commissioner to take into account the whole of the arrangement including any interposed entities or financial arrangements in ascertaining whether an investment in a FIF provides the New Zealand resident investor with a return akin to a New Zealand dollar denominated debt investment.

On this basis, where a New Zealand resident invests in the NZD Share Class of the Fund, and holds an attributing interest in the FIF, I consider that it is appropriate for the investor holding that investment to be excluded from using the FDR method.

Scope of determination

This determination is issued on the basis of information provided to the Commissioner before the date of this determination. It applies to an attributing interest in a FIF held by New Zealand resident investors in a non-resident issuer where:

- This non-resident issuer:
  - is incorporated in Ireland and issues multiple classes of shares; and
  - is known at the date of this determination as The Colchester Multi-Strategy Global Bond Fund PLC; and
  - is structured as an umbrella fund with segregated liability between sub-funds.
- The attributing interest consists of the New Zealand dollar denominated class of shares issued in The Colchester Global Green Bond Enhanced Currency Fund, a sub-fund of The Colchester Multi-Strategy Global Bond Fund PLC. This class of shares provides an interest in the underlying assets of the Fund that predominantly (i.e. 80% or more by value at any time in the income year) consist of financial arrangements such as international fixed interest securities; and
- The investment assets attributable to the New Zealand dollar denominated class of share are subject to foreign currency hedging arrangements undertaken by the non-resident issuer for the purpose of eliminating to the extent possible any exchange rate risk for New Zealand investors where this removes 80% to 125% of foreign currency risk for the assets.

Conditions

It is a condition of this determination that the investment in the Fund is part of an overall arrangement that seeks to provide the New Zealand resident investor with a return that is economically equivalent to a debt instrument denominated in New Zealand dollars.

In addition, it is a condition of this determination that an investor will not be excluded from using the FDR method to calculate FIF income from an interest where the absolute notional value of the Fund's investment in global fixed income securities (directly or indirectly via derivatives) plus the fair value of the related hedges plus cash and cash equivalents (together referred to as "the numerator") is 80% or less than the combined total of the numerator plus the absolute nominal value of other derivatives (together referred to as "the denominator") for a continuous period of 45 days. For the purposes of calculating the numerator and denominator hedging to NZD is excluded. Should this occur, the determination will cease to apply from the first day of the quarter immediately following the expiry of the 45 day period.

Interpretation

In this determination, unless the context otherwise requires -

"Fair dividend rate method" means the fair dividend rate method under section YA 1 of the Income Tax Act 2007;

"Financial arrangement" means financial arrangement under section EW 3 of the Income Tax Act 2007;

"Foreign investment fund" means foreign investment fund under section YA 1 of the Income Tax Act 2007;

"New Zealand resident" means a person that is resident in New Zealand for the purposes of the Income Tax Act 2007.

"Non-resident" means a person that is not resident in New Zealand for the purposes of the Income Tax Act 2007;

"The Fund" means The Colchester Global Green Bond Enhanced Currency Fund, a sub-fund of The Colchester Multi-Strategy Global Bond Fund PLC.

Determination

An attributing interest in a FIF to which this determination applies is a type of attributing interest for which a person may not use the fair dividend rate method to calculate FIF income from the interest.

Application Date

This determination applies for the 2024-2025 income year and subsequent income years.

However, under section 91AAO(3B) of the Tax Administration Act 1994, this determination does not apply for a person and an income year beginning before the date of the determination unless the person chooses that the determination applies for the income year.

Dated on this day, 01 July 2024.

Iain McConville
Technical Specialist

DEP112: Tax Depreciation Rate for metal (scrap) recovery plant

Issued: 12 June 2024

This determination sets a revised depreciation rate for metal (scrap) recovery plant and a change to the asset class description.

Note to determination DEP112

The Commissioner was asked to consider a depreciation rate for a scrap metal shredder including sorting plant components, used to process larger items of scrap metal that do not represent recycled general household waste material.

What is the asset?

A metal (scrap) recovery plant (now replaced by a new asset class description of "scrap metal shredder including sorting plant") likely includes a number of components in a plant process used to recover recycled scrap metal. A shredder or hammer-mill is an important early-stage component. A "scrap metal shredder including sorting plant" may include other components which have the purpose of sorting the different streams of metal and removing unwanted rubbish. The purpose of a shredder or hammer-mill (when used) is to break scrap metal down into small pieces of a suitable size for smelting, whereas the wider plant operation may include other components to separate the various types of metals from the scrap source and dispose of the unrecyclable materials. The other components of the plant process, for example, may include electromagnets to sort ferrous materials and eddy current generators to sort non-ferrous metals, vibrating screens, conveyors, blowers, dust collection systems or any of the other components of the sorter. It operates as a system, and "scrap metal shredder including sorting plant" is an accurate description of its purpose and what it is.

Industry category

The Cleaning, Refuse and Recycling industry category asset category in the Commissioner's Table of Depreciation Rates, groups together different industry activities that may employ similar assets, to avoid repetition of the assets and rates elsewhere. The grouping does not imply that a business in one activity is necessarily engaged in all of the varied activities grouped under the industry category. For example, a waste collection operator may only be engaged with processing metal scrap for sale to another industry (manufacturer or metal smelter operators) but not involved with the collection of household refuse that is sent to a general waste landfill.

DEP112: Tax Depreciation Rates General Determination Number 112

This determination may be cited as "Determination DEP112 Tax Depreciation Rates General Determination Number DEP112: Scrap metal shredder including sorting plant.

Application

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

This determination applies for the 2024 and subsequent income years.

Determination

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

- Delete from to the "Cleaning, Refuse and Recycling" industry category, the estimated useful life, and general diminishing value and straight-line depreciation rates for the asset class listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
"Metal (scrap) recovery plant," from the 2024 income year.	20	10	7

- Add to the "Cleaning, Refuse and Recycling" industry category, the estimated useful life, and general diminishing value and straight-line depreciation rates for the asset class listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
"Scrap metal shredder including sorting plant," from the 2024 income year – previously described as "metal (scrap) recovery plant".	15.5	13	8.5

Interpretation

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

This determination is signed on the 12th day of June 2024.

Matthew Evans
Technical Lead, Technical Standards, Legal Services
Inland Revenue

INTERPRETATION STATEMENT

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

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

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

Some interpretation statements may be accompanied by a fact sheet summarising and explaining the main points. Any fact sheet should be read alongside its corresponding interpretation statement to completely understand the guidance. Fact sheets are not binding on the Commissioner. Check **taxtechnical.ird.govt.nz/publications** for any fact sheets accompanying an interpretation statement.

IS 24/04: Trustee of employee share scheme trust treated as nominee

Issued | Tukuna: 12 June 2024

This interpretation statement considers the available subscribed capital, treasury stock and dividend implications of a trustee of an employee share scheme holding shares as nominee.

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

Introduction | Whakataki

1. The employee share scheme (ESS) tax regime changed in 2018. The objective of the changed rules is to treat ESS benefits neutrally so that, to the extent possible, whether remuneration for labour is paid in cash or shares the tax position does not change for either the employer or the employee.
2. Following the changes to the rules, we have received various questions about how the law applies in certain scenarios. This statement addresses some of those questions by explaining the tax implications of treating a trustee of an ESS trust as a nominee under the changed rules. It also provides examples to illustrate how the rules apply.

Tax treatment of an ESS trust

3. As defined in s CE 7, an ESS is broadly an arrangement with a purpose or effect of issuing or transferring shares in a company to an employee if it is connected to the employee's employment or service. In this context, an employee includes a person who will be, is, or has been an employee or shareholder–employee of the company. An ESS includes providing shares to employees of another company in the same group, or to an associate of an employee, if this arrangement is in connection with the employee's employment or service. For ease of reference, this interpretation statement uses the term "employee" to cover all potential ESS beneficiaries where relevant (including where shares are provided to the employee's associates).
4. The use of the term "arrangement" in the definition of an ESS covers all aspects of a scheme that has a purpose or effect of issuing or transferring shares to employees, including where a trust is set up to administer an ESS. The activities of a trustee of a trust set up to administer an ESS (ESS Trustee) may include:
   - receiving contributions from employers;
   - acquiring and transferring shares in accordance with the terms of the ESS (eg purchasing on-market or from employees, subscribing in the company or transferring to employees when ESS criteria are met);
   - maintaining a pool of shares that can be allocated to, or forfeited by, employees in accordance with the terms of the ESS;
   - facilitating and administering loans to employees that are used to acquire shares;
   - receiving payments when shares are allocated, or transferred, to employees and making payments where shares are forfeited by, or reacquired from, employees; and
   - receiving dividends paid on shares that it holds and applying those dividends in accordance with the terms of the ESS.

5. Section CE 6 provides for an ESS Trustee to be treated as a nominee for tax purposes:

CE 6 Trusts are nominees

A trustee is treated as the nominee of a company (company A) to the extent to which the trustee's activities relate to an employee share scheme or an exempt ESS and—

(a) shares or related rights in company A are issued or transferred under the scheme:

(b) shares or related rights are issued or transferred to company A's employees, shareholder-employees, or associates of them, under the scheme.

6. Section CE 6 provides for the ESS Trustee to be treated as nominee of the company whose shares are the subject of the ESS. Alternatively, if this company is different from the employer company, the ESS Trustee may be treated as the nominee of either or both of these companies. Such a difference might arise where, for example, a parent company's shares are the subject of the ESS. Where the ESS Trustee could potentially be nominee for two different companies under s CE 6, we consider that the ESS Trustee will be nominee for the company that is most relevant to the activity the ESS Trustee is undertaking at the time, as in these examples:
   - For the transfer and holding of shares under the ESS, the ESS Trustee will be treated as nominee for the company whose shares are at issue (rather than the employer if a different company). This is consistent with the purpose of s CE 6, which is to ensure shares held by the ESS Trustee can be treated as held as treasury stock to eliminate any uncertainty around whether an ESS Trustee holds shares on revenue account.
   - Where there are funding costs to provide loans to employees, the ESS Trustee would be treated as nominee for the employer company.
7. One possible interpretation of s CE 6 is that the ESS Trustee is only treated as nominee of the relevant company to the extent of the issue or transfer of shares or related rights. However, we consider the better view is that paras (a) and (b) of s CE 6 serve to identify the company that the trustee is treated as nominee for, rather than to limit the effect of s CE 6 to those issues or transfers. This is because it would not make sense to treat the company as issuing or transferring the shares under s CE 6, but not subject to the related circumstances or consequences of holding those shares. Further, if s CE 6 only applied to the extent of the issue or transfer of shares or related rights, there would be no need to refer to both the company whose shares are at issue and (if different) the employer company.
8. Accordingly, for tax purposes, to the extent an ESS Trustee's activities relate to an ESS, it will be treated as nominee of the company whose shares are the subject of the ESS and (if different) the employer company. This means that the activities of the ESS Trustee on behalf of those companies will be treated as activities that the companies themselves undertake directly.
9. Where an ESS Trustee holds shares in a company on the terms of the ESS, and is treated as nominee of the company, the effect (for tax purposes) is to treat the:
   - company as holding shares, and issuing and buying back shares, in itself; and
   - ESS Trustee as not holding, and not acquiring or transferring, shares in the company.
10. This means that, for tax purposes, the company is treated as holding the shares in itself held by the ESS Trustee in accordance with the treasury stock rules. This in turn has flow-on effects for the company's available subscribed capital and how dividends on those shares are treated for tax purposes. The following sections discuss these matters in more detail.

Available subscribed capital

11. The concept of available subscribed capital (ASC) is important in determining whether a distribution by a company to its shareholders is a dividend. This is because ASC can be returned to shareholders on certain off-market share buybacks (s CD 22) or on liquidation (s CD 26) and not be a dividend.
12. Section CD 43 sets out how to calculate the amount of a company's ASC for a class of share at a point in time. Broadly, it reflects the amounts paid to the company on the issue of shares, less amounts paid out on the repurchase of shares when those amounts are not treated as dividends under specified rules. Section CD 43 sets out adjustments for specific scenarios and transactions.

13. Section CD 43 has been amended to expressly address the situation where an ESS Trustee is treated as nominee for the company whose shares are the subject of the ESS. Relevantly, subss (1) and (2) of s CD 43 state (with underlining added to highlight where the section addresses shares held by an ESS Trustee):

> **CD 43 Available subscribed capital (ASC) amount**
>
> *Formula for calculating amount of available subscribed capital*
>
> (1) For a share (the share) in a company at any relevant time (the calculation time), the amount of available subscribed capital is calculated using the formula—
>
> 1 July 1994 balance + subscriptions − returns − look-through company returns.
>
> *Definition of items in formula*
>
> (1) In the formula in subsection (1),—
>
> (a) **1 July 1994 balance** is,—
>
> (i) if the company existed before 1 July 1994, the amount calculated under subsection (3); and
>
> (ii) in any other case, zero:
>
> (b) **subscriptions**, subject to subsections (6) to (21), is the total amount of consideration that the company received, after 30 June 1994 and before the calculation time, for the issue of shares of the same class (the class) as the share, ignoring section HB 1 (Look-through companies are transparent), and including consideration for the issue of shares by the company as a result of the application of section CE 6 (Trusts are nominees):
>
> (c) **returns**, subject to subsections (22) and (23), is the total amount of consideration that the company paid, after 30 June 1994 and before the calculation time, on the cancellation of shares in the relevant class and that was not a dividend because of section CD 22, CD 23B, or CD 24 or a corresponding provision of an earlier Act:
>
> (d) **look-through company returns** is the total amount of consideration that the company paid, before the calculation time, on the cancellation or buyback of shares in the relevant class while the company was a look-through company, ignoring section HB 1.
>
> [Bold emphasis in original; underlined emphasis added]

14. As set out under [13], a company is treated as having a “subscriptions” amount (increasing its ASC) where it is treated as receiving consideration for the issue of shares under s CE 6.
15. Because the ESS Trustee is nominee of the company under s CE 6, the shares it holds in the company under the ESS will be treated as held by the company itself for tax purposes. This means that, where the ESS Trustee sells shares on market or transfers shares to an employee, for tax purposes the company will be treated as selling or transferring its own shares. This would generally constitute an issue, or re-issue, of the company’s shares. Accordingly, any consideration received by the ESS Trustee for the sale or transfer that, applying s CE 6, is treated as consideration received by the company for an “issue” of its shares, may therefore give rise to an increase in ASC in the company (subject to the treasury stock rules). In the context of an ESS Trustee being nominee for a company under s CE 6, an “issue” of shares may also include situations where the ESS Trustee allocates shares (or rights to shares) to an employee in accordance with the terms of the ESS. We discuss this in more detail in the context of the treasury stock rules from [18].
16. For completeness, where the company (or the ESS Trustee as nominee) receives consideration for the “issue” of shares from a subsidiary company in the same wholly owned group as the company under an ESS, the consideration will not give rise to an increase in ASC (s CD 43(20B)). This is because other subsections of s CD 43 (eg s CD 43(6E) to (6K) and (29)) address the effect of the provision of ESS benefits and related intra-group payments on the ASC of the relevant group members.
17. In brief, in addition to the amount received for the issue of shares under s CD 43(2)(b), s CD 43(6E) to (6K) provide for an amount of ASC to arise for the employing company and (if different) the share issuing company. As a starting position, an amount of ASC arises equal to the amount that is a benefit for the employee and expenditure for the employer, with some adjustments. Conceptually, the tax treatment is the same as if the company paid the amount in cash to the employee as remuneration and the employee then used the cash to subscribe for the shares.

Application of the treasury stock rules

18. Under the Companies Act 1993 (CA 1993), a company incorporated in New Zealand can hold its own shares. While the presumption is that when a company acquires its own shares they are cancelled (s 66, CA 1993), the company is permitted to elect to hold up to 5% of its own shares (s 67A, CA 1993). Where a company holds shares in itself under s 67A of the CA 1993, the rights attached to the shares are suspended under s 67B of the CA 1993 – that is, the company cannot vote or receive distributions in respect of the shares.
19. As a company can hold shares in itself under the CA 1993, the Income Tax Act 2007 contains provisions to address what happens for tax purposes in such a situation. The key provision is s CD 25 concerning "treasury stock". Broadly, s CD 25 allows a company to hold shares in itself as treasury stock for up to 1 year, and the payment to acquire those shares will not give rise to a dividend for the seller shareholder or any ASC or imputation consequences for the company. However, if the company does not make an arm's length transfer of a share of the same class within a year, or if it cancels the share within that year, then ASC and imputation consequences occur.
20. In addition to dealing with the situation of a company holding shares in itself in accordance with the CA 1993, s CD 25 expressly addresses a company being treated as holding shares in itself under s CE 6 due to the activities of an ESS Trustee.
21. Section CD 25 states (with bold added to highlight where the section addresses shares held by an ESS Trustee):

> **CD 25 Treasury stock acquisitions**
>
> Treasury stock *generally*
>
> (1) An amount paid by a company in acquiring any of its shares is not a dividend if—
>
> (a) the shares acquired by the company are held by the company in itself, **including shares acquired by the company as the result of the application of section CE 6 (Trusts are nominees)** and, in the case of shares acquired other than as the result of the application of section CE 6, section 67A(1) of the Companies Act 1993 or section 24 of the Co-operative Companies Act 1996 apply to provide that the shares are not deemed to be cancelled; and
>
> (b) the acquisition is not part of a pro rata cancellation or something that is in substance a pro rata cancellation.
>
> *Reversion to on-market cancellation treatment*
>
> (2) Subsections (4) to (6) apply in the case of an acquisition of a share to which subsection (1) or section CD 17(1) of the Income Tax Act 2004 or section CF 3(1)(d) or (da) of the Income Tax Act 1994 applies if,—
>
> (a) before the first anniversary of the acquisition, the company cancels the share; or
>
> (b) at the first anniversary, the company has failed to transfer a share of the same class in an arm's length transfer **and has failed to allocate a share or right to a share, of the same class to an employee share scheme beneficiary under an employee share scheme**, except if the company is established under New Zealand co-operative company legislation; or
>
> (c) after the first anniversary, the company, which is established under New Zealand co-operative company legislation, cancels the share.
>
> *Requirement for arm's length transfers*
>
> (3) When subsection (2)(b) is applied,—
>
> (b) a transfer is arm's length only if it is—
>
> (i) to a person not associated with the company; or
>
> (ii) in a transaction that occurs on a recognised exchange, through a broker or some other agent independent of the company, and that is not preceded by any arrangement between the transferee and the company for the transfer; and
>
> (b) each arm's length transfer of a share is taken into account only in relation to a single share acquisition to which subsection (1) has applied.

INTERPRETATION STATEMENTS

Reduction of available subscribed capital

(4) If subsection (2) applies, then, with effect from the cancellation or the first anniversary, depending on which first causes subsection (2) to apply, the available subscribed capital of the class of the share is reduced by the lesser of—

(a) the amount paid to the shareholder on the acquisition; and

(b) the available subscribed capital per share calculated under the ordering rule and, in the case of the first anniversary, calculated as if the share and any other shares to which this subsection applies on that date were cancelled on that date.

Imputation credit account debit

(45) If subsection (2) applies, then, with effect from the date of the acquisition by the company, section OB 42 (ICA on-market cancellation) applies as if the original acquisition were an on-market cancellation but item "ASC per share excess" of the formula in section OB 42 were equal to only the excess of the amount received by the shareholder over the reduction described in subsection (4).

Relief from imputation penalty tax

(6) No imputation penalty tax is imposed under section 140B of the Tax Administration Act 1994 (nor any late payment penalty imposed under that Act in relation to the imputation penalty tax) if it would not have arisen had subsection (5) applied only with effect from the date of cancellation or first anniversary, depending on which first causes subsection (2) to apply.

Employee share schemes

(7) **For the purposes of subsection (2), if the company has, before the first anniversary, allocated a share or right to a share to an employee share scheme beneficiary under an employee share scheme but subsequently the allocation is cancelled, the shares acquired under subsection (1) by the company are treated as acquired by the company on the date of cancellation for the amount the company paid for their acquisition under subsection (1).**

[Emphasis added]

22. As emphasised above, in the context of s CD 25 and an ESS, a distinction is drawn between a share (or a right to a share) being allocated to an employee under the terms of the ESS and a share (or a right to a share) not being allocated to an employee. The clear inference from subss (2B) and (7) is that where a share (or a right to a share) is allocated to an employee it is treated as being held by the company on trust for the purposes of the ESS. This is in contrast with shares (or rights to shares) that are not allocated to an employee under an ESS; unallocated shares are treated as held by the company in itself and subject to the treasury stock rules.

23. The effect of ss CE 6 and CD 25 is that where an ESS Trustee acquires, holds and transfers shares in a company on the terms of an ESS, the company is treated as undertaking those activities.

24. This means that when the ESS Trustee acquires a share on market or from an employee, the company will be treated as acquiring the share and holding it in itself as treasury stock, and any payment made by the ESS Trustee to acquire that share will not be treated as a dividend to the recipient (s CD 25(1)(a)). The concept of an ESS Trustee acquiring a share for these purposes includes where an employee forfeits a share (or a right to a share) that the ESS Trustee previously allocated to them such that it becomes unallocated (subss (2)(b) and (7)).

25. The ESS Trustee then has 1 year to make an arm's length transfer of a share, or allocate a share (or a right to a share) to an employee under an ESS, of the same class in accordance with s CD 25(2).

26. Where the ESS Trustee meets the conditions at [25] within a year, then no ASC or imputation consequences result under s CD 25(4) to (6). For completeness, the following applies in this situation:

- No additional ASC arises in respect of consideration received for such an "issue" of shares. This is because the issue means that the amount paid on the previous share acquisition is not subject to s CD 25(4) to (6) (s CD 43(19)).
- If shares (or rights to shares) are allocated to an employee within the year, but that allocation is later cancelled, then under s CD 25(7) those shares are treated as acquired by the company on the date of the cancellation for the amount paid for their initial acquisition (ie the amount initially paid for the acquisition referred to at [24] above).

27. Where the ESS Trustee fails to make an arm's length transfer or allocate a share to an employee within a year, then under s CD 25(4) the ASC of the company for the class of the share is reduced by the lesser of:
    - the amount paid for the acquisition referred to at [24] above; and
    - the ASC per share calculated under the ordering rule as if the shares to which s CD 25(4) applies on that date were cancelled on that date.
28. Where the ASC per share calculated under the ordering rule is less than the amount paid for the acquisition, and therefore the ASC is reduced by that amount under s CD 25(4), imputation consequences will also result under s CD 25(5) and (6) and s OB 42. Broadly, an imputation debit will arise calculated by reference to the company tax rate and the "ASC per share excess", being the surplus of the amount paid for the acquisition over the ASC reduction.
29. Example | Tauira 1 and Example | Tauira 2 explain how the treasury stock and ASC rules apply to scenarios involving an ESS Trustee.

Example | Tauira 1 – Treasury stock treated as cancelled and then applied for the purposes of the ESS

The trustee of an ESS trust acquires 700 Employer Co shares on market for $2.50 per share. However, delays occur and shares are not allocated to employees within 12 months.

After 18 months, when the shares are worth $3.50 per share, the trustee allocates the 700 shares to an employee for $3.00 per share. The purchase price (700 × $3.00 = $2,100) is funded by an employee loan from the trust.

If the employee is still employed by Employer Co 1 year after this allocation, the employee will receive a $2,100 bonus from Employer Co (grossed up for PAYE). The employee must use this to repay the loan and the trustee will transfer the 700 shares to the employee.

If the employee leaves this employment before the year is up, they will forfeit their benefit and the trustee will retain the shares in satisfaction of the employee loan (ie the shares will return to being unallocated in the ESS trust).

One year after allocation, the shares are worth $5 each.

ASC result for Employer Co

The trustee's acquisition of the 700 shares is treated as an acquisition of treasury stock by Employer Co for $2.50 each.

As the 700 shares are not allocated to an employee within 12 months, the acquisition is treated as reverting to an on-market cancellation under s CD 25(2). This means that, with effect from the first anniversary of acquisition, under s CD 25(4) Employer Co's ASC of the class of share is reduced by the lesser of:

- the amount paid on acquisition (700 × $2.50 = $1,750); and
- the ASC per share calculated under the ordering rule as if the shares to which s CD 25(4) applies were cancelled on that date.

The 700 unallocated shares are effectively treated as having been cancelled under s CD 25(4). When the trustee later allocates those shares to an employee for the purchase price of $3 per share, under s CE 6 Employer Co is treated as issuing 700 shares for $3 per share and it will have ASC of $2,100 under s CD 43(2)(b).

For completeness, if the employee stays employed for a year, then ASC will arise for Employer Co in respect of the benefit provided to the employee. This will be equal to the amount that is a benefit for the employee and expenditure for Employer Co under the ESS rules (s CD 43(6E)(a)):

700 shares × ($5 market value – $3 cost) = $1,400.

Example | Tauira 2 – Treasury stock treated as cancelled and then sold on market in the course of winding up the ESS

The trustee of an ESS trust acquires 700 Employer Co shares on market for $2.50 per share. Six months later, when they are worth $3 per share, it allocates 350 shares to an employee for $2 per share. The purchase price (350 × $2 = $700) is funded by an employee loan from the trust.

If the employee is still employed by Employer Co after 1 year, the employee will receive a $700 bonus from Employer Co (grossed up for PAYE). The employee must use this to repay the loan and the trustee will transfer the 350 shares to the employee.

If the employee leaves this employment before the year is up, they will forfeit their benefit and the trustee will retain the shares in satisfaction of the employee loan (ie the shares will return to being unallocated in the ESS trust).

One year after allocation, the shares are worth $5 each.

ASC result for Employer Co

The trustee's acquisition of the 700 shares is treated as an acquisition of treasury stock by Employer Co for $2.50 each.

In respect of the 350 shares allocated to the employee within 12 months of acquisition, the acquisition is not treated as reverting to an on-market cancellation under s CD 25(2). Accordingly, s CD 25(4) does not apply to treat the amount paid to acquire those shares (350 × $2.50 = $875) as reducing Employer Co's ASC. Likewise, the $700 the employee paid to acquire the shares does not increase Employer Co's ASC (s CD 43(19)).

If the employee stays employed for a year, then ASC will arise for Employer Co in respect of the benefit provided to the employee. This will be equal to the amount that is a benefit for the employee and expenditure for Employer Co under the ESS rules (s CD 43(6E)(a)):

350 shares × ($5 market value - $2 cost) = $1,050.

If the employee does not stay for 12 months and the shares become unallocated again, Employer Co will be treated as acquiring those 350 shares at that time for $2.50 per share ($875). This is the amount for which the shares were initially acquired on market (s CD 25(7)). This acquisition will not reduce Employee Co's ASC if it allocates the shares to another employee within 12 months.

Additional facts – ESS trust to be wound up and remaining unallocated shares sold on market

Out of the 700 Employer Co shares that the trustee acquired on market for $2.50 per share, 350 were not allocated in accordance with the ESS within a year.

Employer Co decides to wind up the ESS trust. Accordingly, the 350 unallocated shares held by the trustee are sold on market for $5.50 per share (in aggregate $1,925). Any cash remaining in the ESS trust is returned to Employer Co when it is wound up.

ASC result for Employer Co

For the 350 shares that are not allocated to an employee within 12 months, the acquisition is treated as reverting to an on-market cancellation under s CD 25(2). This means that, with effect from the first anniversary of acquisition, under s CD 25(4) the ASC of the class of share is reduced by the lesser of:

- the amount paid on acquisition (350 × $2.50 = $875); and
- the ASC per share calculated under the ordering rule as if the shares to which s CD 25(4) applies were cancelled on that date.

The unallocated shares are effectively treated as having been cancelled under s CD 25(4). When the trustee sells those shares on market for $5.50 per share, s CE 6 applies: Employer Co is treated as issuing 350 shares on market for $5.50 per share. ASC of $1,925 will arise for Employer Co under s CD 43(2)(b).

Dividend implications

30. As set out at [18], where a company holds shares in itself, rights attached to the shares are suspended under s 67B of the CA 1993. In other words, the company cannot receive dividends from itself on shares it holds in itself.

31. However, s 67B of the CA 1993 will not apply where an ESS Trustee holds shares in a company under the terms of an ESS. It is only for tax purposes that the ESS Trustee is treated as nominee for the company under s CE 6, and therefore the company is only treated as holding shares in itself for tax purposes.

32. Accordingly, dividends may still be paid on the shares held by an ESS Trustee and applied in accordance with the terms of the ESS. As set out from [22], under s CD 25 whether shares are treated as held by a company as treasury stock in itself for tax purposes depends on whether the shares are allocated to an employee or not. Each of these situations is considered below.

Unallocated shares held by an ESS Trustee

33. Where an ESS Trustee holds shares that are not allocated to an employee, the ESS Trustee often waives its entitlement to dividends under s 53(3) of the CA 1993 (ie essentially "switched off"). If it does not waive the entitlement, the ESS Trustee usually retains the dividends to defray operational costs or returns them to the company.

34. As the company is treated as holding its own shares under s CE 6, there is no dividend for tax purposes as the company cannot transact with itself or pay dividends to itself. There is no "transfer of company value from a company to a person" under ss CD 4 to CD 6.

35. Where the ESS Trustee uses the cash from the dividend to, for example, defray expenses, then the treatment of those expenses will need to be considered in the ordinary manner. In other words, this will involve treating the ESS expenses as an expense of the company under s CE 6 and determining whether that expense is deductible to the company in accordance with the Income Tax Act 2007. Sections DA 1 and DV 27 will need to be considered in terms of expenditure incurred under the ESS.

Allocated shares held by an ESS Trustee

36. As set out from [22], in the context of an ESS Trustee and ss CD 25 and CE 6, the way a company is treated as holding shares that an ESS Trustee holds depends on whether the shares are allocated to an employee. If they are not, the company holds those shares as treasury stock in itself. However, the outcome of s CD 25 is that where an ESS Trustee allocates shares to an employee, the company is not treated as holding shares as treasury stock in itself. Instead, it is holding those shares on trust for the purposes of the ESS.

37. How dividends paid on shares allocated to an employee are treated for tax purposes will depend on the terms of the ESS.

38. The ESS Trustee may waive its entitlement to dividends under s 53(3) of the CA 1993, in which case no dividend will arise to consider for tax purposes.

39. The employee may be entitled to the dividends under the terms of the ESS. This could take the form of, for example, being entitled to receive the dividends, or having the dividends dealt with on their behalf in repayment of an employee loan (if they obtained one to acquire the share allocation). Assuming the ESS Trustee pays the dividend to the employee or deals with the dividends on the employee's behalf within the timeframe required by s HC 6, the dividends will be beneficiary income of the employee.

40. An amount that an employee derives in an income year as beneficiary income is income under ss HC 17 and CV 13(a). The dividend income will retain its character in the hands of the employee as beneficiary income. Accordingly, the usual tax implications of paying a dividend to a beneficiary of a trust as beneficiary income will result – for example, as regards imputation credits, withholding taxes and related tax credits. This outcome is consistent with treating shares held by an ESS Trustee that are allocated to an employee as held by the company (under s CE 6) but for the benefit of the employee and not as treasury stock (under s CD 25).

41. Where dividends are paid on allocated shares but the employee does not have any entitlement to them, they may be applied by the ESS Trustee in the same way that dividends on unallocated shares are applied – for example, to defray operational costs or be returned to the company. In such a situation, the same result as for unallocated shares effectively arises. The dividend is applied for the benefit of the company that will be treated for tax purposes as receiving a dividend from itself (under ss CE 6, CV 13(a) and HC 6). Accordingly, there is no "transfer of company value from a company to a person" under ss CD 4 to CD 6 and therefore no dividend for tax purposes.

42. Where dividends are paid on allocated shares but the employee does not have any entitlement to them, a different tax outcome from that set out at [41] may potentially arise where the employer company is different from the company whose shares are the subject of the ESS. This is because the ESS Trustee may be nominee for both of those companies under s CE 6, and therefore in some circumstances a transfer of company value from a company (the company whose shares are the subject of the ESS) to a person (the employer company) may arise. The tax implications in such circumstances will depend on the particular facts and are not considered in this statement.

Summary and examples

43. Figure | Hoahoa 1 summarises the discussion of dividend implications in this section.

Figure | Hoahoa 1 – Treatment of dividends on shares held by ESS Trustee

ESS Trustee holds shares in accordance with ESS as:	Dividends waived by ESS Trustee (s 53(3), CA 1993)	Dividends paid to ESS Trustee (ie not waived)
Unallocated shares – any cash used to defray operational costs or returned to company	No distribution, therefore no dividend for tax purposes	No dividend as no transfer of company value by a person to a person for tax purposes (ss CD 4 to CD 6, CD 25 and CE 6)
Allocated shares – employee entitled to dividends under ESS	Not applicable	If dividends paid to employee or dealt with on their behalf within the timeframe required by s HC 6, dividends are beneficiary income of the employee (ss CD 25, CE 6, CV 13(a) and HC 17)
Allocated shares – employee not entitled to dividends under ESS and any cash used to defray operational costs or returned to company	No distribution, therefore no dividend for tax purposes	No dividend as no transfer of company value by a person to a person for tax purposes (ss CD 4 to CD 6, CD 25, CE 6, CV 13(a) and HC 6)

44. Example | Tauira 3 and Example | Tauira 4 explain the tax implications of dividends paid on shares held by an ESS Trustee.

Example | Tauira 3 – Shares held by ESS Trustee and dividends on unallocated shares waived

The trustee of an ESS trust holds shares in Parent Co to meet obligations to employees under Employer Co's ESS.

Out of the 1,000 shares in Parent Co that the trustee holds, 750 are allocated to employees of Employer Co. The employees purchased their allocation using employee loans from the trust. The trustee will transfer shares to the relevant employee when they have completed 3 years of employment.

Any dividends paid on the allocated shares will be immediately applied (after deduction of any applicable taxes) to repay the employee loans.

The trustee waives its entitlement to dividends on the 250 unallocated shares under s 53(3) of the CA 1993.

Dividend implications

No dividends are paid on the unallocated shares as the trustee has waived its entitlement to those dividends.

As any dividends paid on shares allocated to an employee are immediately applied by the trustee in repayment of the employee's loan, such dividends will be treated as beneficiary income of the employee under ss CD 25, CE 6, CV 13(a) and HC 6. Accordingly, imputation credits and withholding taxes will apply to those dividends in the same way as they would apply to any other payment of a dividend to a trustee that is beneficiary income.

Example | Tauira 4 – Shares held by ESS Trustee and all dividends applied to defray ESS operational costs

The trustee of an ESS trust holds shares in Employer Co to meet obligations to employees under an ESS.

Out of the 1,000 shares in Employer Co that the trustee holds, 750 are allocated to employees and 250 are unallocated. Allocated shares are transferred to the relevant employee when they have completed 3 years of employment.

The trustee does not waive its entitlement to dividends for any of the shares. An employee is not entitled to dividends on any allocated shares under the ESS until they complete 3 years of employment and the shares are transferred to them.

While the shares are held in trust, whether allocated or unallocated, the terms of the ESS provide for the trustee to retain any dividends and apply them to defray operational costs.

Dividend implications

Applying s CE 6, dividends paid on the unallocated shares are, for tax purposes, a payment of an amount by Employer Co to Employer Co. Accordingly, there is no transfer of company value by a person to a person for tax purposes and therefore no dividend for tax purposes (ss CD 4 to CD 6).

For dividends paid on the allocated shares, Employer Co is treated as holding those shares for the purposes of the ESS and not as treasury stock (under ss CD 25 and CE 6). However, as the employee has no entitlement to the dividends and the trustee applies them to defray ESS operational costs, these dividends are dealt with on behalf of Employer Co under s CE 6. Accordingly, there is no transfer of company value by a person to a person for tax purposes and therefore no dividend for tax purposes (ss CD 4 to CD 6, CD 25, CV 13(a) and HC 6).

Where the ESS operational costs relate to a loan or interest, or to establishing or managing the ESS, they will likely be deductible to Employer Co under ss DA 1 and DV 27(3).

Legislative references | Tohutoro whakatureture

Companies Act 1993, ss 53, 66, 67A, 67B

Income Tax Act 2007, ss CD 4 to CD 6, CD 22, CD 25, CD 26, CD 43, CE 6, CE 7 (“employee share scheme”), CV 13, DA 1, DV 27, HC 6, HC 17, OB 42

QUESTIONS 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 24/03: Fringe benefit tax – employee share loans and associates

Issued | Tukuna: 12 June 2024

This question we've been asked explains whether the employee share loan exclusion from fringe benefit tax can apply when an associate of the employee enters into a loan to acquire shares in connection with the employee's employment.

Key provisions | Whakaratonga tāpua

Income Tax Act 2007, ss CX 2, CX 10, CX 35, GB 32

Question | Pātai

Does a fringe benefit arise where a trustee of a family trust that is associated with an employee is provided a loan to acquire shares under an employee share scheme?

Answer | Whakautu

No, a fringe benefit does not arise in this situation, provided that a fringe benefit would not arise if the employee were provided the loan to acquire the shares under the employee share scheme in the same circumstances.

Explanation | Whakamāramatanga

Introduction

1. An employee share scheme (ESS) is defined in s CE 7. Broadly, it is an arrangement with a purpose or effect of issuing or transferring shares in a company to an employee if it is in connection with the employee's employment or service. An ESS includes providing shares to an associate of an employee, if that is done in connection with the employee's employment or service. Where an associate receives the shares, it is still the employee that receives any employment income from the ESS under s CE 1(1)(d) and s CE 2.
2. The terms of an ESS may provide for making an interest-free loan to the employee to enable them to purchase the shares under the ESS. Where an employer (or another person by arrangement of the employer) provides an interest-free loan to an employee in connection with their employment, it is generally a fringe benefit unless an exclusion applies. Relevantly, loans under an ESS are often made on terms that fall within the "employee share loan" exclusion from fringe benefit tax (FBT). An employee share loan is a loan provided to an employee for the sole purpose of enabling them to acquire shares in the employer or group company, provided certain criteria are met.
3. When a benefit is provided to an associate of an employee, it is treated as provided to the employee (and a fringe benefit) as long as it would be a fringe benefit if it was provided to the employee.
4. We have been asked whether the employee share loan exclusion from FBT can apply when a trustee of a family trust (Trustee) that is an associate of the employee enters into the loan and acquires the shares under the terms of the ESS, instead of the employee.

The answer

5. The Commissioner considers that where a loan is provided to a Trustee that is an associate of the employee in circumstances that would satisfy the employee share loan exclusion if the Trustee were the employee, the loan will not give rise to a fringe benefit. For the purposes of this question we've been asked (QWBA), it is assumed that the employee is a participant in an ESS and, under the terms of the ESS, the employer (or another person by arrangement with the employer) makes a loan to the Trustee on the following terms:
    - The loan must be used for the sole purpose of the Trustee acquiring shares in a company that is the employer or an associate of the employer.

- The Trustee uses the loan only for the purpose of the acquisition.
- The Trustee maintains beneficial ownership of the shares throughout the term of the loan. "Beneficial ownership" in the context of the employee share loan exclusion is discussed from [37] to [41].
- The Trustee must immediately repay the loan in full if it ceases to have beneficial ownership of the shares.

6. For the purposes of this QWBA, the following assumptions also apply:
   - The ESS is not an "exempt ESS" (as defined in s CW 26C).
   - The employer and employee are not associated (under the definition of "associated" in s YA 1).
   - The company whose shares are subject to the ESS maintains a dividend paying policy through the term of the loan and is not a "qualifying company" or a "look-through company" (as each of those terms is defined in s YA 1).
   - The Trustee is associated with the employee under the definition of "associated" in s YA 1.
7. For completeness, the Commissioner acknowledges that the above analysis could apply to other associates of the employee as well – for example where the above facts and assumptions are satisfied by the employee's spouse, civil union partner or de facto partner.
8. This QWBA does not consider the implications of any anti-avoidance provisions and the outcomes set out may not apply where the general anti-avoidance provision (s BG 1) applies.

What is a fringe benefit?

9. Section CX 2 defines fringe benefit:

> CX 2 Meaning of fringe benefit
>
> *Meaning*
>
> (1) A **fringe benefit** is a benefit that—
>
> (a) is provided by an employer to an employee in connection with their employment; and
>
> (b) either—
>
> (i) arises in a way described in any of sections CX 6, CX 9, CX 10, or CX 12 to CX 16; or
>
> (ii) is an unclassified benefit; and
>
> (c) is not a benefit excluded from being a fringe benefit by any provision of this subpart.
>
> *Arrangement to provide benefit*
>
> (2) A benefit that is provided to an employee through an arrangement made between their employer and another person for the benefit to be provided is treated as having been provided by the employer.
>
> *Past, present, or future employment*
>
> (3) It is not necessary to the existence of a fringe benefit that an employment relationship exists when the employee receives the benefit.
>
> *Relationship with subpart RD*
>
> (4) Sections RD 25 to RD 63 (which relate to fringe benefit tax) deal with the calculation of the taxable value of fringe benefits.
>
> *Arrangements*
>
> (5) A benefit may be treated for the purposes of the FBT rules as being provided by an employer to an employee under—
>
> (a) section GB 31 (FBT arrangements: general):
>
> (b) section GB 32 (Benefits provided to employee's associates).

10. Section CX 2(1) states that a fringe benefit is a benefit that is provided by an employer to an employee in connection with their employment, that arises under a specific provision or is an unclassified benefit, and that is not specifically excluded by a provision in subpart CX.
11. The remainder of s CX 2 broadens the scope of fringe benefit in the following ways:
    - Where a benefit is provided to an employee by someone other than the employer, it is treated as having been provided by the employer if it is provided by arrangement with the employer: s CX 2(2).

- It is not necessary for an employment relationship to exist when the employee receives the benefit: s CX 2(3).
- A benefit may be treated as provided by an employer to an employee under s GB 31 (specific anti-avoidance rule where an arrangement is entered into to defeat the intent and application of the rules) or s GB 32 (where a benefit is provided to an associate that would be a fringe benefit if provided to an employee): s CX 2(5).

12. Therefore, in analysing the implications of a Trustee associated with an employee obtaining a loan to acquire shares under an ESS, this QWBA considers in turn:
    - applying the FBT rules to a loan;
    - applying the FBT rules to an associate; and
    - applying the FBT rules to the scenario set out in this QWBA.

Applying the FBT rules to a loan

13. Section CX 10 states:

> CX 10 Employment-related loans
>
> *When fringe benefit arises*
>
> (1) A fringe benefit arises when an employer provides a loan to an employee.
>
> *Exclusions*
>
> (2) Subsection (1) does not apply to a loan made—
>
> (a) as an employee share loan:
>
> …
>
> *Loan owing*
>
> (3) The employer provides a fringe benefit in a tax year in which the loan is owing. The circumstances in which a loan is owing include a case in which, under the arrangement for the loan, an amount is payable in the future, or would be payable in the future if a particular event happened, and the employee or an associated person is or would be liable to pay the amount.

14. Accordingly, a loan that an employer (or another person by arrangement of the employer) provides to an employee in connection with their employment is generally a fringe benefit under ss CX 2 and CX 10 unless an exclusion applies. Relevantly, it will not be a fringe benefit if it is an employee share loan as s CX 10(2)(a) sets out.
15. Section YA 1 provides that an "employee share loan" is defined in s CX 35, which in turn states:

> CX 35 Meaning of employee share loan
>
> *Meaning*
>
> (1) Employee share loan means a loan made to an employee if—
>
> (a) the loan is made for the sole purpose of enabling the employee to acquire, under a scheme of acquisition,—
>
> (i) shares, rights, or options in the company that is their employer:
>
> (ii) shares, rights, or options in a company that is associated with their employer; and
>
> (b) the employee uses the loan only for the purpose of the acquisition; and
>
> (c) the employee beneficially owns the shares, rights, or options throughout the term of the loan; and
>
> (d) the employee must immediately repay the loan in full if they stop being the beneficial owner of any of the shares, rights, or options; and
>
> (e) the company issuing the shares, rights, or options must maintain a dividend-paying policy throughout the term of the loan.
>
> *Exclusions*
>
> (2) This section does not apply—
>
> (a) to shares, rights, or options in a qualifying company:
>
> (b) to a loan made under an exempt ESS:
>
> (c) to an employer and an employee who are associated persons.

16. The requirements of s CX 35(1) demonstrate the purpose of the FBT exclusion for employee share loans is that FBT should not arise for a low-interest loan where an employee obtains the loan to acquire an income-earning asset. This is because s CX 35(1) effectively requires the loan to be used, and used only, for the purpose of acquiring shares where the company maintains a dividend paying policy. This is further supported by a requirement that the employee is the beneficial owner over the term of the loan. This means the employee cannot obtain the use of the loaned funds for another purpose by retaining legal ownership in the shares while selling beneficial ownership.
17. The above purpose apparent from the terms of s CX 35(1) is reflected in the material surrounding the introduction of the FBT exclusion. Section CX 35 was originally enacted in 1996 as the definition of an "employee share loan benefit" in s OB 1 of the Income Tax Act 1994. The commentary on the Taxation (Remedial Provisions) Bill (May 1996) provided the rationale for introducing the employee share loan exclusion from FBT:

> The bill introduces two further specific exclusions from fringe benefit tax (FBT). The exclusions relate to employee share purchase plan (ESP) loan benefits and tax assistance given to employees. **The exclusions allow certain fringe benefits to be provided to employees without incurring FBT because an employee would have been able to get a deduction had he or she actually incurred the expense.**
>
> …
>
> The bill introduces two specific exclusions to the fringe benefit definition in section CI 1 of the Income Tax Act 1994:
>
> - An exclusion for loan benefits **if the sole purpose of the loan is to enable the employee to acquire shares in the employer** under an ESP;
>
> …
>
> Some situations have been identified where the **payment of FBT** on the benefits which are the subject of the FBT exclusions provided for in this amendment **would result in overtaxation. This arises if an employee would have been entitled to a tax deduction for the expenditure incurred on the provision of the fringe benefit**. In most cases this can be avoided by structuring the provision of the fringe benefit in a different way. The exclusions provided for in the bill remove the need to restructure the provision of these benefits. [Emphasis added]

18. The requirements of s CX 35(1) and the apparent purpose of the employee share loan exclusion from FBT emphasise the importance of the loan being used for the sole purpose of obtaining shares under the ESS. Interest on a loan being generally deductible when used to acquire an income-earning asset underlies the FBT exclusion. To apply FBT to the loan benefit in such circumstances would likely result in over-taxation.
19. For completeness, if the employee borrowed the funds to acquire the shares and then transferred those shares to an associate, it is clear the s CX 35 FBT exclusion would not apply. This is because the employee would not retain ownership of the shares while the loan is outstanding. In terms of the underlying purpose of the employee share loan FBT exclusion, any interest on the loan would not have been deductible by reason that the employee incurred it in deriving their assessable income, because it is the associate that would be deriving any dividend income from the shares.

Applying the FBT rules to an associate

20. As set out in s CX 2(5)(b), a benefit may be treated for the purposes of the FBT rules as being provided by an employer to an employee under s GB 32. This is relevant if the employee's associate (the Trustee) obtains the loan to acquire the shares under the ESS.

21. Section GB 32 states:

> GB 32 Benefits provided to employee's associates
>
> *When this section applies*
>
> (1) This section applies when—
>
> (a) a benefit is provided to a person who is associated with an employee of an employer; and
>
> (b) the benefit would be a fringe benefit if provided to the employee; and
>
> (c) the benefit is provided either by the employer or by another person under an arrangement with the employer for providing the benefit; and
>
> (d) the exemptions in subsections (2) and (2B) do not apply.
>
> …
>
> *Benefit treated as provided to employee*
>
> (3) For the purposes of the FBT rules, the benefit is treated as provided by the employer to the employee.
>
> …

22. If a benefit provided to the Trustee meets the requirements of s GB 32(1), and the exemptions set out in s GB 32(2) and (2B) do not apply to the benefit (such exemptions are not relevant to the scenario in this QWBA), then under s GB 32(3) the benefit is treated as provided by the employer to the employee for the purposes of the FBT rules. This means even though the benefit is provided to an associate rather than the employee, it would give rise to FBT.

23. The purpose of s GB 32 is clear from its requirements and its placement in subpart GB as a specific anti-avoidance provision. The FBT rules cannot be avoided by providing a benefit to an employee's associate in connection with their employment, rather than to the employee directly. Such benefits are treated as fringe benefits under s GB 32, so long as they would be fringe benefits if they were provided to the employee.

24. Section GB 32 was originally enacted as s 336N(3) in the Income Tax Act 1976. *Public Information Bulletin* Part 1, Number 136 (May 1985) provided commentary on the newly enacted FBT rules. It states the following about s 336N(3):

> - Benefits provided to associated persons of the employee
>
> Section 336N(3) provides that "... where any benefit which, if it were provided for or granted to an employee would be a fringe benefit, is provided or granted by the employer of the employee, or is provided or granted by another person with whom the employer of the employee has entered into an arrangement for the providing or granting of that benefit, for or to a person other than the employee of the employer, the employee of the employer and the other person being associated persons, that benefit shall be deemed to be a benefit provided for or granted to the employee by the employer of the employee. "
>
> The effect of this provision is that **the fringe benefit tax legislation applies to any benefit provided to an associated person of an employee in the same manner as if that benefit had been provided to the employee. As this deeming provision applies for the purposes of the whole of the fringe benefits tax legislation, references in the legislation to benefits provided to an employee should be read as including benefits provided to an associated person of the employe[e]**. [Emphasis added]

25. This commentary is consistent with the purpose of s GB 32. As demonstrated by the requirements of s GB 32, that purpose is to ensure the FBT rules can apply to a benefit provided to an associate in the same manner as if that benefit had been provided to the employee. For this to occur, the provisions of the FBT rules need to be able to work where the benefit is provided to an associate rather than the employee. The commentary to the new FBT legislation in the *Public Information Bulletin* suggests that this is achieved by reading references in the FBT rules to benefits provided to an employee as including benefits provided to an associate.

26. Where a loan is provided to an associate of an employee on the terms set out at [5] and [6], s GB 32(1) would apply as follows:
    - A benefit (the loan) is provided to a person (the Trustee) associated with an employee of the employer (s GB 32(1)(a)).
    - The benefit (the loan) is provided by the employer or another person under an arrangement with the employer (s GB 32(1)(c)).
    - The exemptions in s GB 32(2) and (2B) do not apply (s GB 32(1)(d)).
27. Accordingly, the key question is whether "the benefit would be a fringe benefit if provided to the employee", as s GB 32(1)(b) sets out. If it would be a fringe benefit in these circumstances, the FBT rules will apply to the benefit under s GB 32(3). If it would not, the FBT rules will not apply because a benefit is not treated as being provided to an employee.

Applying the FBT rules to the scenario set out in this QWBA

28. If the employee rather than the Trustee had obtained the loan and acquired the shares on the terms set out at [5] and [6], the loan would meet the requirements of s CX 35 to qualify as an employee share loan. It would not be a fringe benefit under s CX 10(2)(a).
29. The question is whether the exclusion for employee share loans set out in ss CX 10(2)(a) and CX 35 can apply where the loan is provided to the Trustee. In other words, can the exclusion apply when determining whether the loan provided to the employee's associate "would be a fringe benefit if provided to the employee" for the purposes of s GB 32(1)(b)?
30. The context of the ESS rules, the FBT rules and the underlying purposes of the exclusion for employee share loans (s CX 35) and the extension of the rules to benefits provided to associates (s GB 32) is important. In this context, the Commissioner considers it is necessary to determine whether the loan to the Trustee would be a fringe benefit if provided to the employee by reading references to the employee in s CX 35 as being references to the associate.
31. For a fringe benefit to arise if a benefit is provided to an associate, it must be in circumstances where that benefit would give rise to a fringe benefit for the employee. For the FBT rules to apply to a benefit provided to an associate in the same manner as if that benefit had been provided to the employee, the same exclusions set out in the FBT rules that apply to the employee must be able to apply to the benefit the associate obtained.
32. In other words, where the Trustee has received the benefit (the loan – s CX 10, satisfying s GB 32(1)(a)), treating the associate as the employee for the purposes of applying s CX 35, would that give rise to a fringe benefit (and in that way satisfy s GB 32(1)(b))?
33. This approach is consistent with the purpose underlying both ss CX 35 and GB 32. As outlined from [16] to [18], the purpose of s CX 35 is to ensure FBT is not applied where an employee would likely have been allowed a deduction for interest incurred to acquire an income-earning share, because imposing FBT in such circumstances would result in over-taxation. Where the Trustee obtains a loan to acquire shares with a dividend paying policy, the Trustee would likely have been allowed a deduction for costs associated with the loan (in the same manner as the employee). Accordingly, interpreting the requirements of s CX 35 as relating to an employee or the associate for the purposes of applying s GB 32 allows the purpose of s CX 35 to be met.
34. Further, this approach is consistent with the apparent purpose of s GB 32 outlined from [23] to [25]. The loan is not being provided to the Trustee rather than the employee to avoid FBT. If the employee were to obtain the loan to acquire the shares under the ESS instead of having the Trustee do this, the loan would not be subject to FBT due to the application of s CX 35.
35. Therefore, in order to determine whether the loan provided to the Trustee would be a fringe benefit if provided to the employee under s GB 32(1)(b), the Commissioner reads references to the employee as references to the associate in s CX 35. The requirements of s CX 35 are therefore as follows:
    - Is the loan made for the sole purpose of enabling the associate to acquire, under a scheme of acquisition:
      - shares, rights or options in the company that is the employer; or
      - shares, rights or options in a company that is associated with the employer?
    - Does the associate use the loan only for the purpose of the acquisition?
    - Does the associate beneficially own the shares, rights or options throughout the term of the loan?
    - Must the associate immediately repay the loan in full if they stop being the beneficial owner of any of the shares, rights or options?
    - Does the company issuing the shares, rights or options maintain a dividend paying policy throughout the term of the loan?

36. On the assumptions set out at [5] and [6], the loan the Trustee obtains to acquire the shares under the ESS would meet the requirements of s CX 35. This is because the loan is tied to the acquisition and beneficial ownership of the shares, and the company maintains a dividend paying policy. Accordingly, the benefit would not be a fringe benefit if it was provided to the employee and s GB 32(3) will not treat the provision of the benefit as provided by the employer to the employee. This means no FBT will arise.

Comment on whether the Trustee can "beneficially own" shares for the purposes of s CX 35(1)(c)

37. In terms of general trust law, a trustee is often referred to as holding legal title of assets in respect of which the beneficiaries of the trust have beneficial ownership. However, s CX 35 simply refers to the employee acquiring shares and having beneficial ownership of the shares during the term of the loan. It does not only apply to situations involving trusts.
38. Courts that have considered "beneficially owns", or similar terms, caution that it must be interpreted in context and in light of the purpose of the section in which it occurs. As Gallen J concluded in *Martin v Martin* [1988] 1 NZLR 722 (HC) at 731 (approved in *FCT v Linter Textiles Australia Ltd (In Liq)* 2005 ATC 4,255 at [50]):

    In my view, it follows from the cases that the term "beneficial ownership" is to be construed in context and must reflect the purposes of the section in which it occurs.

39. Consistent with the above judicial comment, courts have interpreted "beneficially owns" in different ways depending on the context in which the phrase is used. For example, various cases concerning succession duty have held that persons holding funds to apply in a particular way on trust for a purpose have had a beneficial interest in the funds. For example, in *Perpetual Trustees, Estate, and Agency Co of New Zealand, Ltd v Commissioner of Stamp Duties* [1927] NZLR 714, Stringer J delivering the judgment of the Court of Appeal held that a church had a beneficial interest in a bequest to the church that was to be applied for the purposes of its foreign missionary work. Stringer J discussed a number of cases that had considered a person holding funds on trust for a purpose, or to be applied in a particular manner, as being beneficially entitled for the purposes of succession duty.
40. In the context of employee share schemes and in terms of the purpose of s CX 35 described at [16] to [19] and the requirements of the section, what is essential is the nexus, or degree of connection, between the interest expense and the dividends and the acquisition of shares. This indicates that the requirement for the employee to "beneficially own" the shares means the employee must own the rights that give the shares value, in particular the rights to dividends. This interpretation is consistent with the purpose of preventing employees from selling the rights carried by the shares and using the proceeds for a different purpose. However, given many employee share schemes involve restrictions on an employee's ownership of shares for a certain period, it might be expected that the employee does not have the right to dispose of the shares during the term of the loan or call for legal title.
41. Where a trustee of a family trust holds the shares in accordance with the deed establishing the family trust and is entitled to the fruits of ownership of those shares (eg dividends and voting) to direct and control for the purposes of the family trust in line with the trust deed, the trustee should be considered beneficial owner of those shares in the context of and for the purposes of s CX 35. For this reason, we consider the trustee of a family trust, in their capacity as trustee of the family trust and applying funds in accordance with the terms of the trust, may be a beneficial owner of the shares for the purposes of s CX 35(1)(c) and (d).

References | Tohutoro

Legislative references | Tohutoro whakatureture

Income Tax Act 1976, s 336N(3)

Income Tax Act 1994, s OB 1 ("employee share loan benefit")

Income Tax Act 2007, ss BG 1, CE 1(1)(d), CE 2, CE 7, CW 26C ("exempt ESS"), CX 2 ("fringe benefit"), CX 10, CX 35 ("employee share loan"), GB 32, YA 1 ("associated", "qualifying company", "look-through company")

Case references | Tohutoro kēhi

Martin v Martin [1988] 1 NZLR 722 (HC)

FCT v Linter Textiles Australia Ltd (In Liq) 2005 ATC 4,255

Perpetual Trustees, Estate, and Agency Co of New Zealand, Ltd v Commissioner of Stamp Duties [1927] NZLR 714

Other references | Tohutoro anō

Commentary on the Taxation (Remedial Provisions) Bill (May 1996)

Public Information Bulletin Part 1, Number 136 (May 1985)

QB 24/04: When is a subdivision project a taxable activity for GST purposes?

Issued | Tukuna: 21 June 2024

This Question We've Been Asked sets out when a subdivision project is an activity carried on continuously or regularly in the definition of "taxable activity" for GST purposes. It also sets out when the sale of subdivided land is a supply made in the course or furtherance of a taxable activity.

Key provisions | Whakaratonga tāpua

Goods and Services Tax Act 1985 – s 6

REPLACES | WHAKAKAPIA:

Tax Information Bulletin Vol 7 No 2 (August 1995), "GST and subdivisions – Court of Appeal decision in the *Newman* case", Tax Information Bulletin Vol 7, No 2 (August 1995): 10.

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

Question | Pātai

When is a subdivision project a taxable activity for GST purposes?

Answer | Whakautu

A subdivision project is a taxable activity when it is carried on continuously or regularly and involves, or is intended to involve, the making of supplies to another person for consideration.

Whether a subdivision project is carried on continuously or regularly needs to be considered on a case-by-case basis.

There are two steps to determining whether a subdivision project is continuous or regular. These are to consider:

- the number of lots created and sold; and
- the level of activity involved in the subdivision project, such as the scale of the subdivision and level of development work involved.

Broadly, the more lots created and sold (and therefore the more supplies made), the less activity is needed for a taxable activity to be continuous or regular. Generally, a subdivision leading to only one supply will not be a taxable activity unless the scale of the activity and level of work involved is very high. This is because cases indicate an activity leading to one supply that is not repeated is a "one-off" activity and therefore not continuous or regular. On the other hand, a subdivision leading to four or more supplies is likely to be a taxable activity unless the level of activity is very low.

This does not mean a subdivision activity leading to only one sale can never be a taxable activity or a subdivision activity leading to four or more sales will always be a taxable activity. The facts of each case must be considered individually. An example of an activity leading to one supply that would be a taxable activity is the construction and sale of a large office building. However, the construction and sale of a regular residential dwelling as part of a subdivision will generally not be a taxable activity.

Key terms | Kīanga tau tāpua

Subdivision means dividing a parcel of land into two or more, or changing an existing boundary location. For the purpose of this item, references to a subdivision also include any development or building work on the land carried out as part of a subdivision project, unless otherwise specified.

Explanation | Whakamāramatanga

1. A policy statement titled "GST and subdivisions – Court of Appeal decision in the *Newman case*" was published in *Tax Information Bulletin* Vol 7, No 2 (August 1995): 10.
2. That policy statement outlined the Commissioner of Inland Revenue's position following the decision in *Newman v CIR* (1995) 17 NZTC 12,097 (CA). According to the statement, whether a subdivision project is a taxable activity for GST purposes depends on the facts of each case, considering factors such as the scale of the subdivision, level of development work, time and effort involved, amount of financial investment, and commerciality of the transaction.
3. The Commissioner considers many of these factors are still relevant when considering whether a subdivision is a taxable activity. This Question We've Been Asked outlines factors that might affect whether a subdivision project is continuous or regular, provides guidance on factors that are not likely to be relevant, and addresses some other related considerations regarding subdivisions and GST registration.

Legislation

4. Section 8(1) imposes GST on the supply of goods and services in New Zealand by a registered person in the course or furtherance of a taxable activity. A Taxpayer who is carrying on a taxable activity may be required to register for GST.[1] For general guidance on GST registration and requirements, see the Inland Revenue guide IR 375, *GST Guide: Working with GST*.
5. "Taxable activity" is defined in s 6. Under s 6(1)(a), the main features of a taxable activity are:
   - there is an activity;
   - the activity is carried on "continuously" or "regularly"; and
   - the activity involves, or is intended to involve, the supply of goods and services to another person for a consideration.
6. The courts have held that an "activity" is a broad concept involving a combination of tasks undertaken, or a series of acts or course of conduct pursued by a person.[2] Subdividing land is almost always an activity for GST purposes.
7. Subdivision is also usually an activity that involves, or is intended to involve, the supply of goods or services to another person for a consideration. This is usually satisfied as, in most instances, some or all of the subdivided land is sold or otherwise used for supplying goods and services. However, this is not always the case, such as where the subdivided land is kept for private use or for making exempt supplies.
8. This means that, in the context of a subdivision project, the most relevant factor will generally be whether the activity is carried on continuously or regularly. This Question We've Been Asked focuses on this factor.

Carried on continuously or regularly

9. "Carried on" has been described as "the habitual pursuit of a course of conduct, and as implying "a repetition of acts, and excluding the case of an association formed for doing one particular act which is never to be repeated.[3]
10. In general terms, an activity is carried on continuously if it is carried on over a period or in a sequence uninterrupted in time or if it is connected.[4] An activity is carried on regularly if it is carried on accordance with a definite course or a uniform principle of action or conduct, or if a proper correspondence exists between the elements of the activity.[5]
11. It can be difficult to work out whether a subdivision project is a continuous or regular activity. This is because activities involving land usually involve a lot of work, time, and cost, but the number of supplies made is often low.
12. Cases confirm it is the activity that must be continuous or regular, not the making of supplies. However, the meaning of "continuously or regularly" must be considered in the context of the definition of taxable activity and the wider scheme of the GST Act.[6] In this context, the types of activities contemplated seem to be those leading to the making of multiple supplies over time.[7]

[1] The requirements and conditions for GST registration are set out in ss 51 and 51B.

[2] See, for example, *CIR v Bayly* (1998) 18 NZTC 14,073 (CA) at 14,078, and *Case 14/2016* (2016) 27 NZTC 3,036 at [63].

[3] *Newman* (CA) per Richardson J at 12,100, citing *Premier Automatic Ticket Issues Ltd v Federal Commissioner of Taxation* (1933) 50 CLR 268 at 298; *Smith v Anderson* (1880) 15 CH D 247 at 277, 278 respectively.

[4] *Wakelin v CIR* (1997) 18 NZTC 13,182 (HC).

[5] *Wakelin* at 13,185-13,186.

[6] *Newman* (CA) per Gault J at 12,102.

[7] Consistent with the position taken in *Newman* (CA).

13. The following guidance has been developed from comparing the facts, analysis, and outcomes of cases concerning the GST treatment of subdivisions. This is designed to assist taxpayers in working out whether a subdivision project they are involved in or plan to be involved in is an activity carried on continuously or regularly, potentially requiring GST registration.
14. This item first provides a brief overview of the reasoning in the two most prominent cases concerning whether a subdivision activity is a taxable activity. It then outlines the relevant factors when determining whether a subdivision project is a taxable activity following the reasoning in these cases and other subsequent Taxation Review Authority decisions. The QWBA then briefly addresses some other relevant considerations.
15. Before *Newman*, courts and the Taxation Review Authority found almost all subdivisions to be taxable activities. The Commissioner considers these cases are no longer relevant as the interpretation of "continuously or regularly" differs from that taken in *Newman* and later cases.

Newman

16. The leading case on the meaning of "carried on continuously or regularly" in the context of subdivisions is *Newman* (CA).
17. The taxpayer in *Newman* was a GST-registered builder who bought 2.7 hectares of land to build a family home. Due to financial difficulties, he subdivided the land to fund the completion of the family home. Minimal development work was undertaken, but some drainage and electrical work was done. Eventually, the taxpayer sold the subdivided lot.
18. The Commissioner determined this subdivision was a taxable supply. The Taxation Review Authority and High Court both found that the sale of the subdivided lot was a taxable supply.[8] This was consistent with most cases before *Newman*, where almost all subdivisions were found to be taxable activities.
19. However, on appeal, the Court of Appeal unanimously allowed the taxpayer's appeal and found the sale of the subdivided land was not, by itself, a taxable activity as it was not an activity carried on continuously or regularly.
20. In reaching its decision, the Court of Appeal stated that dissection of what was done into a series of sequential steps does not answer the statutory test of whether the activity was carried on continuously.[9] The Court used examples of shopping or selling a car as activities which, if broken down into a series of steps, could be described as carried on continuously. Instead, what is relevant is whether the activity (of which the series of steps formed part) was one that was carried on continuously or regularly. On the topic of sale of a motor car, McKay J considered that if the sale was of only one car, the amount of work, time, and effort required to effect the sale cannot determine whether the activity of selling the car was continuous or regular. Instead, the one-off nature of the transaction prevents the activity from being continuous.[10]
21. The Court of Appeal in *Newman* deliberately did not express a view as to what would make a particular subdivision a taxable activity.[11] The Court acknowledged that some factual circumstances will be hard to classify but stated it will be a matter of fact and degree.[12]

Wakelin

22. The High Court decision in *Wakelin v CIR* is often contrasted with *Newman*.[13] The taxpayer in *Wakelin* carried out subdivision work on a block of land. The taxpayer subdivided the land into six residential lots over a period of three years, and then sold all of the lots over the following six years. The case concerned five of the sales.
23. The High Court found that although there was not a "great deal" of work involved, and it could have been done in a relatively short time, the taxpayer continuously and regularly subdivided a portion of land and supplied five sections to the market over several years.[14]
24. The High Court distinguished *Newman* primarily based on the number of supplies made. While Paterson J acknowledged it is the activity that must be continuous or regular, not the supply of goods, the number of supplies made is still relevant.[15]
25. Following *Newman*, there have been several Taxation Review Authority cases concerning the GST treatment of subdivisions. Where relevant, these cases have been referenced and relied on in the guidance below.

[8] *Case P4* (1992) 14 NZTC 4,024, *Newman v CIR* (1994) 16 NZTC 11,229 (HC).
[9] *Newman* (CA) per Richardson J at 12,101.
[10] *Newman* (CA) per McKay J at 12,104.
[11] *Newman* (CA) per Richardson J at 12,101.
[12] *Newman* (CA) per Richardson J at 12,101, per Gault J at 12,103, per McKay J at 12,104.
[13] *Wakelin v CIR* (1997) 18 NZTC 13,182 (HC).
[14] *Wakelin* at 13,186.
[15] *Wakelin* at 13,185.

Relevant factors

26. *Newman* and *Wakelin* provide contrasting examples of what is and it not a taxable activity in the context of subdivision projects. The taxpayers in both cases did a similar amount of work to effect the subdivisions, but one led to one supply and the other led to five supplies. These cases indicate the first step to consider is the number of lots created and sold.

Number of lots created and sold

27. There is no specific number of lots created that determines whether a taxable activity exists. However, *Newman* and *Wakelin*, other cases considering the meaning of continuously and regularly in this context, such as *Case S70*[16] and *Case T62*,[17] as well as the general scheme of the GST Act, demonstrate that ordinarily a subdivision activity leading to only one supply is not a taxable activity. Such an activity is more accurately described as a single "one-off" activity comprising many steps, rather than an activity carried on continuously or regularly.
28. For example, Paterson J in *Wakelin* was clear that in the case of an activity leading to the supply of one item or one section, "it is difficult to see how in normal circumstances, that activity can be carried on continuously or regularly, because it is in effect, a one-off transaction supplying one item".[18]
29. Similarly, in *Case T62*, Judge Barber found that the subdivision of land into two, and the construction and sale of one apartment on one of the created lots, had the air of a "one-off" transaction.[19] Relating the facts to *Newman*, Judge Barber considered this case did not involve repeated acts by the taxpayers, but merely the components or sequential steps of one activity.[20]
30. On the other hand, where a subdivision activity involves the creation and sale of multiple lots, this may be a taxable activity even if the level of development work is similar to that in *Newman*.[21] This does not mean a subdivision involving the creation and sale of multiple lots will always be a continuous activity.[22] In some circumstances a subdivision may be so straight-forward that even if multiple lots are created and sold, the activity is not continuous or regular. However, a court is much more likely to consider an activity "continuous" if it involves the sale of multiple lots.
31. The lots do not need to have already been created and sold when considering this.[23] Usually a taxpayer will need to work out whether they are going to be carrying on a taxable activity at the outset or before the bulk of the work has been done. However, if the subdivision project does not proceed as planned, the Commissioner will need to determine whether there is enough for a taxable activity to exist. See from [74] for more information about the beginning of a taxable activity.

Effect of number of supplies on other factors

32. Applying this in practice, the Commissioner considers the number of supplies made affects the relevance of other factors when determining whether a taxable activity exists. Broadly, where the activity leads to only one supply, there is a presumption that the activity is not continuous or regular, unless the level of work involved is very high. Where the activity leads to many supplies, there is a presumption that the activity is continuous or regular. While there is no specific number that will determine whether a taxable activity exists, the Commissioner considers generally a subdivision project involving the creation and sale of four or more lots will be a taxable activity, unless the level of work involved is very low.[24]
33. Cases use the example of the construction and sale of a commercial building as an activity leading to one supply that is a taxable activity.[25] The Commissioner considers this is because of the usually high scale of such a project. The level of time and effort, development work, and financial investment in building something like a large office building will usually be very high. The commercial nature of such a project on its own is not relevant. Please see from [57] below on the relevance of commerciality for more information on this.

[16] *Case S70* (1996) 17 NZTC 7,431.

[17] *Case T62* (1998) 18 NZTC 8,468.

[18] *Wakelin* at 13,185, cited with approval in *Case T62*.

[19] *Case T62* at [50].

[20] *Case T62* at [53].

[21] In *Wakelin*, Paterson J distinguished a one-off transaction supplying one item as in *Newman* from the sale of several sections. In *Case T40* (1997) 18 NZTC 8,267, the taxpayer intended to sell four lots but at the time had sold only two. Judge Barber stated it was not a one-off, as it was intended to involve the sale of four, or possibly five, sections. In *Case S70*, Judge Barber stated the level of development work was similar to that in *Newman*, but the increased number of resulting sections (four) was a distinguishing factor.

[22] In *Case S70* Judge Barber acknowledged that the sale of more than one section may not amount to a taxable activity.

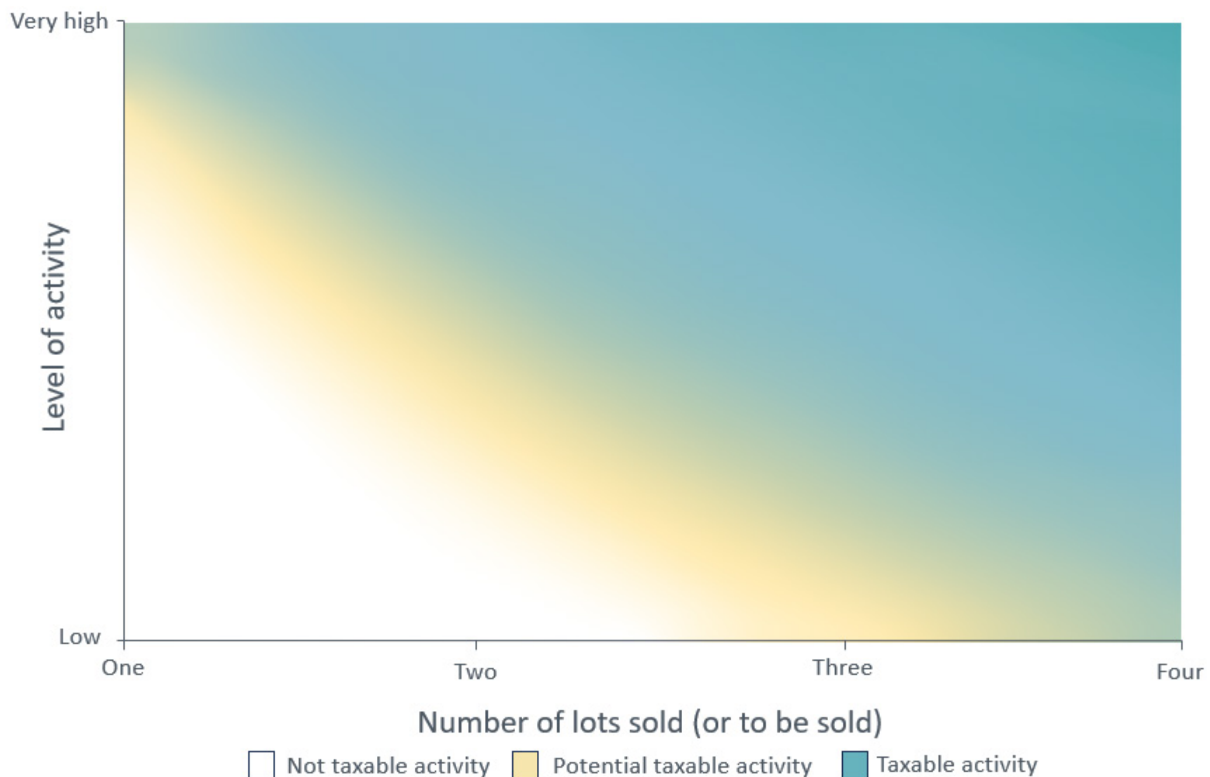
[23] Such as in *Case T40* where only two of the lots had been sold.

[24] This is consistent with *Case S70*, which concerned the creation and sale of four new lots.

[25] *Newman* (HC) at 11,233; *Newman* (CA) at 12,103; *Case S70* at 7,440; *Case T62* at [53].

34. On the other hand, cases indicate a subdivision project that involves the construction and sale of a single residential dwelling is not, on its own, enough for an activity to be continuous or regular.[26]

35. The following diagram illustrates the relevance of the level of activity involved in the project in relation to the number of supplies made (or planned to be made):



36. In summary, when the subdivision activity leads to one supply, a very high level of activity is needed for the activity to be continuous or regular. When the subdivision activity leads to four or more supplies, only a low level of activity is needed for the activity to be continuous or regular. When the subdivision activity leads to two or three supplies, considering the level of activity involved will be particularly important.

37. The relevant factors in considering the level of activity in a subdivision project are discussed below.

38. While the same approach will generally apply to other activities involving the development of land, the same criteria may not apply for other types of activity. The level of work involved in the development of land, and the scale of projects relating to it, relative to the number of supplies made, makes land development projects distinguishable from most other activities.

Level of activity

39. The second step is to look at the level of activity involved in the subdivision project, in light of the number of supplies made. In considering this, the following factors may be relevant when determining whether the activity is continuous or regular:

- the scale of the subdivision;
- the level of development work;
- the time and effort involved;
- the level of financial investment; and
- the level of repetition.

[26] Consistent with *Case T62* and comments in *Newman* (CA) and *Wakelin*. *Case 7/2012* 25 NZTC 1,019 is a case where renovation work on a single dwelling was relevant. However, that was in the context of a much larger high-end residential subdivision project that was intended to lead to multiple supplies. *Case N59* (1991) 13 NZTC 3,457 is a case where the construction and sale of a single residential dwelling was found to be a taxable activity. However, this case predates *Newman* (CA) and is therefore no longer relevant.

40. This is a general guide and is not an exhaustive list. If a taxpayer's circumstances share some elements in common with statements or examples in this QWBA, this does not necessarily mean that the taxpayer's tax treatment will be the same as that indicated by the statements or examples. Ultimately, the activity must be considered as a whole, realistically as it is carried on, and all relevant factors must be considered together.[27]

Scale of the subdivision

41. Scale in this context means how large or extensive the subdivision is. The greater the scale of the subdivision project, the more likely it is to be an activity carried on continuously or regularly. This factor is likely to overlap with the level of development work, as the greater the scale of the project, generally the more development work that is needed.
42. Subdividing land to construct and sell a block of townhouses, or to construct an office building or apartment building, would almost certainly be a subdivision project of sufficient scale for it to be an activity carried on continuously or regularly, even if it leads to only one supply. Similarly, subdividing a large plot of land to be used as a new housing development would be an activity carried on continuously or regularly.

Level of development work

43. It is common for subdivision projects to involve some development of the land, particularly as this is often a requirement for council consent. This item only concerns development work in the context of a subdivision, but similar factors are relevant when determining whether a land development project with no subdivision is a taxable activity.
44. The more development work involved in a subdivision project, the more likely it is to be an activity carried on continuously.[28] While *Newman* (CA) confirmed that an activity should not be broken down into sequential steps, it is still necessary to consider the steps involved in the activity to take a real and holistic view of the activity.[29]
45. Development work might include:
    - earthworks and landscaping;
    - roading and installation of driveways and paths;
    - the installation of facility infrastructure, such as sewerage, power, wastewater drainage and so on;
    - the erection of retaining walls or dividing fences;
    - the demolition, removal, or renovation of existing structures or buildings on the land; and
    - construction of structures or buildings on the land. Larger and more complex structures and buildings usually require a higher level of activity, but this will depend on the particular facts of each case.
46. In all cases, it is the level of development work which is relevant, rather than the specific form the subdivided land takes after development is completed.

Time and effort involved

47. If a project is carried on over a long period, this might point towards the subdivision activity being continuous, particularly where the length of time is due to the level of work required. Similarly, if there is a large amount of effort involved on the taxpayer's part, this may point towards the activity being continuous. This would include any work on the taxpayer's part to effect the subdivision, such as organising consent, finance, or new titles, speaking with lawyers, surveyors and real estate agents, and any other general project management work.
48. It is noted that the time and effort involved in carrying out a subdivision project is likely to be higher if the taxpayer is carrying out development or project management work themselves, rather than hiring contractors to manage the project. This does not mean work carried out by contractors is irrelevant. It may well be relevant to other factors such as the scale of the subdivision and the level of development work. However, if the taxpayer (as an individual or as an entity capable of being a registered person) is putting in very little time and effort to effect the subdivision, this is one factor that might support the view that the taxpayer's activity is not continuous or regular. On its own, this is unlikely to change whether a taxable activity exists, but it is still relevant as part of the broader enquiry.
49. If a subdivision project is interrupted in time or sequence, then it is not continuous or regular. Provided the intention to complete the activity is not interrupted, then an activity being carried on in "fits and starts" does not necessarily prevent it being continuous or regular, as Paterson J found in *Wakelin*.[30] That said, a continuous intention to complete the activity

[27] *Newman* (CA) per Gault J at 12,102.

[28] In *Newman* (CA), the low level of development work was relevant to the conclusion that a taxable activity did not exist.

[29] *Case S70* (1996) 17 NZTC 7,431 at 7,441.

[30] *Wakelin* at 13,186.

is not enough on its own. The more time in which there is no or only very little activity, the less likely an activity is to be continuous or regular. Tompkins J in *Allen Yacht Charters* said an activity that is intermittent or occasional does not qualify as continuous or regular.[31] This means the amount of time taken is irrelevant if it is due to the activity being only intermittent or occasional.

50. In some cases, there may be circumstances outside the taxpayer's control preventing a subdivision from proceeding for an extended period, such as delays in obtaining resource consent. A taxable activity could in some cases continue even when facing extended delays, but each case and all the surrounding circumstances need to be considered. Relevant factors for this might include the reason for the delay, the length of the delay, the level of activity before the delay, and the steps the taxpayer is taking or has taken to ensure the subdivision proceeds as soon as possible.

Level of financial investment

51. The level of financial investment is unlikely to be a significant factor on its own. However, it may provide further support for other factors, such as the scale of the subdivision or level of development work.

52. If a subdivision project is unusually costly because of specific factors relating to the location of the land (for example, if the land is in an area with a labour or material shortage leading to increased prices or extended delays), this is unlikely to affect whether the activity is continuous or regular. Equally, if a subdivision project is particularly cheap due to the taxpayer doing some of the work themselves or receiving assistance, such as if the taxpayer's solicitor is a relative who works for no fee, this is unlikely to affect whether the activity is continuous or regular.

Level of repetition

53. In the context of subdivisions, an activity is likely to be carried on "regularly" if a person carries out the subdivision process on a regular or repeated basis. This will be the case even if each individual subdivision project would not be a taxable activity on its own.

54. This could apply where a person has a pattern of acquiring land to subdivide, or where a person subdivides a single piece of land in a way that involves repeatedly supplying new lots over time. The High Court in *Wakelin* found that subdivision of the taxpayer's land and supply to market of five sections over nine years was an activity carried on both continuously and regularly.[32] Similarly, the TRA in *Case 7/2012* indicated that if the taxpayer's planned subdivision project (which was to involve the development and sale of several high-end residential properties over time) had proceeded as intended, it would have been an activity carried on regularly.[33]

Factors that are not likely to be relevant

55. When considering whether a subdivision activity is continuous or regular, the following factors are not likely to be relevant:
    - Commerciality;
    - Activity before there is an intention to make supplies; and
    - Actions that relate to subdivided land not used for making supplies.

56. This is not an exhaustive list of factors that are unlikely to be relevant.

Commerciality

57. The policy statement and some older cases referred to the relevance of the "commerciality" of a subdivision project, or distinguished between the sale of commercial assets and private assets, when determining whether a taxable activity exists.

58. The Commissioner considers commerciality is no longer significant following *Newman* (CA) and *Wakelin*. Richardson J in *Newman* disagreed with the approach taken by the Taxation Review Authority in *Case P4*. The Authority relied on the conclusion that the subdivision project was "commercial in nature" in reaching its conclusion that the taxpayer was carrying on a taxable activity.[34]

[31] *Allen Yacht Charters Ltd v CIR* (1994) 16 NZTC 11,279 (HC) at 11,274.

[32] *Wakelin* at 13,186.

[33] *Case 7/2012* at [99].

[34] *Case P4* at 4,034.

59. Richardson J stated that determining whether a transaction was commercial in nature was not the relevant enquiry:[35]

> As I see it, it is not a matter of importing any overlay of commercial dealing or of trying to draw a distinction between the divestment of commercial assets and private assets. Rather it is whether the process engaged in, whatever the asset or its location or the occupation of the taxpayer, comes within the statutory language.

60. Judge Barber in *Case S70* later accepted the *Newman* (CA) view that whether a commercial element exists in the relevant activity is "beside the point".[36]

61. Similarly, Paterson J in *Wakelin* stated that lacking a commercial or businesslike flavour does not preclude a taxable activity from existing:[37]

> The fact that the venture may lack a commercial or businesslike flavour or that it may be a sale of private assets is not sufficient to preclude the application of s 6(1). A transaction which involves the sale of private assets, if carried out continuously or regularly, falls within the provisions of the section (see McKay J in *Newman v C of IR*…).

62. As previously stated, comments in *Newman* (CA) and other cases indicate that the construction and sale of a single commercial building on subdivided land is an activity carried on continuously or regularly.[38] The Commissioner's view is that this does not mean the commercial nature of such a project on its own is significant, but instead this reflects the level of activity generally involved in such a project.

63. In some circumstances, constructing and selling a commercial building as part of a subdivision project will not be a taxable activity. The policy statement included an example involving the construction and sale of a tea shop on subdivided land. The example concluded the taxpayer was carrying on a taxable activity as it involved the construction and sale of a commercial building. The Commissioner now considers this example is lacking information, and may be incorrect depending on relevant facts. The level of work involved in building a tea shop may, in some cases, not be notably higher than that involved in constructing a residential dwelling.[39] As previously stated, the Commissioner considers the level of activity involved in the construction and sale of a single residential dwelling is not enough for the activity to be continuous or regular, given it leads to only one supply.

64. These views are consistent with the requirements of s 6. No requirement exists for an activity to be commercial or business-like for it to be a taxable activity. On the contrary, s 6(1)(a) specifies that an activity need not be carried on for pecuniary profit, and non-business structures such as clubs are explicitly included as ways in which an activity can be carried on. This also means a subdivision project need not be profitable for a taxable activity to exist. Judge Barber made this clear in *Case 7/2012*.[40] However, an activity carried on essentially as a private pursuit or hobby is not a taxable activity.[41]

Activity before intention to make supplies

65. The definition of "taxable activity" refers to any activity that involves, or is intended to involve, the supply of goods and services for a consideration. The "or" in "involves or is intended to involve" suggests it is enough for one of these requirements to be met.

66. In *Case T62*, referred to above, two taxpayers bought land with the intention of building two units for their families to live in, but when the units were approximately 65% completed, one of the taxpayers decided to remain in their existing home. Both units were sold to the company the taxpayers operated, with one unit being used as the family home of one of the taxpayers, and the other unit being sold to a third party at a profit.[42]

67. Judge Barber found that because the building activity of the taxpayer's apartment led to its sale, then the activity must have "involved" that supply even though it was not contemplated when the building work began.[43] Judge Barber found neither of the taxpayers were carrying on a taxable activity in relation to the sale of one of the units. One reason given in support of this decision was that the unit was "by then, being built to achieve profit for S by resale, but until then had been for [the purpose of housing S's family]".[44] He considered the work done before that point was not relevant.

[35] *Newman* (CA) at 12,100-12,101.

[36] *Case S70* at 7,440.

[37] *Wakelin* at 13,185.

[38] *Newman* (CA) at 12,101.

[39] However, if the taxpayer operated the tea shop or leased the shop to commercial tenants, rather than selling it, the costs involved in the relevant part of the subdivision and construction would form part of any taxable activity of running or leasing the shop.

[40] *Case 7/2012* at [102].

[41] Section 6(3)(a) and (aa).

[42] Judge Barber did not treat the sale to the company as significant.

[43] *Case T62* at [48].

[44] *Case T62* at [44].

68. For this reason, the Commissioner considers it is not necessary for a taxpayer to intend from the outset to sell some or all of the subdivided lots. In this situation, anything done in the course or furtherance of making that supply after the intention to make supplies for consideration arose is relevant to whether the activity is carried on continuously or regularly. If a taxpayer's intention changes during a subdivision project, the taxpayer has the onus of proving that intention changed and when, as with other factual matters.

Actions that relate to subdivided land not used for making supplies

69. Subdivision and development work that does not relate to the making of supplies is not relevant in determining whether a taxable activity exists. For example, if a taxpayer builds two units on subdivided land, lives in one unit and sells the other, only work and expenditure relating to the unit and land that is sold is relevant in determining the existence of a taxable activity.[45] However, consistent with the previous paragraphs, if a taxpayer intends to live in one of the units but changes their mind and sells both, then all the work involved in the subdivision and development after that intention changed is relevant when determining whether a taxable activity exists.

70. For similar reasons, the use of the land before its subdivision is not relevant. If a taxpayer lives on the land to be subdivided, this is not treated any differently from a subdivision project on land purchased specifically for that purpose. That said, buying a piece of land to subdivide is likely to involve higher upfront cost. It is also likely to require more time and effort in finding the right piece of land, and going through the processes to acquire it. As previously stated, these factors are relevant as part of the overall enquiry.

Other considerations

Existing taxable activity

71. Regardless of other factors, if a taxpayer is already registered for GST, whether any subdivision activity is part of that taxable activity depends on whether the subdivision was carried on in the course or furtherance of that taxable activity. This in turn depends on its connection, if any, to the taxable activity in question.

72. A subdivision activity that might not constitute a taxable activity on its own still gives rise to GST obligations if it was done in the course or furtherance of an existing taxable activity.

73. In *Case P4*, which led to the *Newman* (CA) decision, the Taxation Review Authority found that, even though the taxpayer had a taxable activity as a builder, the subdivision activity was not done in the course or furtherance of that taxable activity.[46] This meant the existence of a taxable activity needed to be established separately, and the subdivision did not become part of the taxpayer's existing taxable activity.

Beginning of a taxable activity

74. Under s 6(2), anything done in connection with the beginning or ending of a taxable activity, including a premature ending, is treated as being carried out in the course or furtherance of the taxable activity. This means that preparatory steps to the commencement of a taxable activity can form part of the taxable activity.

75. That said, preparatory steps on their own are not enough for a taxable activity.[47] A person can register for GST if they have started preparatory steps to carry on a taxable activity, or if they plan to do so from a specific date. However, if the activity does not proceed beyond these preparatory steps, the person must notify the Commissioner, and their registration may be cancelled from the date on which the person was registered.[48] In this situation, the person will not be entitled to any inputs claimed.

76. For anyone who believes they are carrying on a taxable activity but has not registered for GST, the date GST registration takes effect will depend on when the taxpayer applies to register and whether they are liable to register or are registering voluntarily. Please see the IR 375 *GST Guide: Working with GST* for more information about GST registration, and *SPS 18/03: Effective date of GST registrations* for details on effective dates for registration.

77. Note that when a person is registered for GST, if they acquire land with the intention of using it to make taxable supplies, they will usually be required to disclose this to the Commissioner under s 61B of the Tax Administration Act 1994.

[45] *Tout v Cook* (1991) 13 NZTC 8,053 (HC) concerns a similar situation where a taxpayer built a house on subdivided land but then moved into the new house and sold the existing house. The High Court found the taxpayer was not carrying on a taxable activity, and did not consider any activity relating to the new house as relevant.

[46] While the Court of Appeal overturned the decisions of the Taxation Review Authority and High Court, this element of the Authority's decision was not appealed.

[47] Confirmed in *Case 7/2012*.

[48] Section 52 GST Act.

Income tax

78. This item addresses only GST treatment. Even if a subdivision activity is not a taxable activity for GST purposes, **the resulting sale may still be subject to income tax**.
79. For example, if a taxpayer buys land with a purpose or intention of disposing of it, an amount derived from the disposal may be taxable income under s CB 6 of the Income Tax Act 2007. Sections CB 7 to CB 15B of the Income Tax Act 2007 also include in a person's income certain amounts relating to disposal of land, including sections CB 10, CB 12, and CB 13 which specifically refer to subdivisions. They may also need to consider whether the sale is caught by the bright-line property rules.
80. The Commissioner has released several items on the treatment of a sale or disposal of land for income tax purposes. Search the Inland Revenue Tax Technical website for more information.

Avoidance

81. All of the guidance in this item is subject to the GST avoidance provision in s 76. Under s 76, a tax avoidance arrangement entered into by a person is void against the Commissioner for tax purposes. "Tax avoidance arrangement" is an arrangement which has tax avoidance as its purpose or effect, or one of its purposes or effects, if the purpose or effect is not merely incidental. If a tax avoidance arrangement is void against the Commissioner, the Commissioner may adjust the amount of tax payable by, or the amount of tax refundable to, a registered person affected by the arrangement, to counteract any tax advantage obtained.
82. Please see the Commissioner's *Interpretation Statement IS 23/01: Tax avoidance and the interpretation of the general anti-avoidance provisions sections BG 1 and GA 1 of the Income Tax Act 2007* for more information about tax avoidance.[49]

Examples | Tauira

83. These examples/tauira assume the resulting sales of subdivided land exceed the GST registration threshold of $60,000. These examples/tauira also assume that the arrangements are not tax avoidance arrangements under s 76.

Example | Tauira 1 – Basic subdivision

Mike and Megan are not registered for GST. They have owned their own home in Auckland for 20 years. They subdivide their section into two to sell one lot and put the proceeds towards retirement savings.

Mike and Megan carry out development work to meet Auckland Council's requirements for consent. They engage contractors to:

- construct sealed road access and an extended driveway to the rear section;
- level terrain and improve drainage for stormwater management; and
- install water, wastewater, telecommunications and power infrastructure and connections.

In addition to the fees for contractors and materials, and the time and effort of managing the project, Mike and Megan incurred costs to apply for consent, as well as professional fees (for surveyors, lawyers, real estate agents and so on), development contribution fees, and Land Information New Zealand fees. Once a new certificate of title is issued for the lot, Mike and Megan put the land up for sale, and it sells within a month. Mike and Megan continue to live in their house on the front section.

Are Mike and Megan carrying on a taxable activity?

GST treatment

Mike and Megan's subdivision activity is not a taxable activity as it is not carried on continuously or regularly. The subdivision is a straight-forward subdivision into two lots. While there is development work to meet Council consent requirements, and associated time, effort, and cost to meet these requirements, this is a one-off activity leading to only one supply that is not to be repeated. The level of activity is not sufficiently high for the activity to be carried on continuously.

[49] While this statement is primarily concerned with avoidance for income tax purposes, it is also relevant to s 76 as s 76 is aligned with s BG 1 of the Income Tax Act 2007. This is specified at para [1.3] of IS 23/01.

Example | Tauira 1B – Creation of three lots

The background is the same as that in Example | Tauira 1, but Mike and Megan have a large section that can be subdivided to create three extra lots. The work required to carry out the subdivision is similar, but on a somewhat larger scale due to the increased number of lots created and larger section. More terrain-levelling work is required, and there is more work to create the extended driveway.

As with Example | Tauira 1, Mike and Megan put the extra three lots up for sale once new certificates of title have been issued. They continue to live in their house on the front section.

Are Mike and Megan carrying on a taxable activity?

GST treatment

Mike and Megan are likely to be carrying on a taxable activity. While the facts are similar to those in the previous example, the increased number of sections created is a notable distinction. Courts are much more likely to consider an activity to be continuous or regular if it involves making multiple supplies. There is some level of development work to meet Council requirements, and the scale, time, effort, and cost is higher than that in Example | Tauira 1. Together, this may be enough for the activity to be continuous or regular. However, this is a borderline case where a more detailed factual analysis would be required, as specific facts and details may affect whether a taxable activity exists.

Example | Tauira 2 – Subdivision and small-scale development

Jensen is a GST-registered sole trader who runs a business inspecting and repairing ventilation systems.

Jensen's house is leaky and requires substantial repairs and full re-cladding. He receives advice that it would be more cost-effective to demolish the existing house and re-build two townhouses on his land, so he can sell one to offset costs.

Jensen arranges for the land to be subdivided and engages architects and contractors to design and construct the townhouses. Each is a two-storey, three-bedroom townhouse. After demolition and construction, Jensen moves into one townhouse and sells the other.

Is Jensen carrying on a taxable activity of subdivision?

GST treatment

Jensen's subdivision activity is not a taxable activity for GST purposes. This is because it is not an activity carried on continuously or regularly.

Only one new lot was created and sold. Therefore, even though the level of financial investment and development work for the units is fairly high compared to subdividing and selling a bare lot, the work involved is still part of a single one-off activity, and should not be broken down into individual steps. The level of activity is not so large as to make it continuous or regular despite this. Further, the cost and level of work involved in constructing the unit he later lives in is not relevant when considering whether the activity was one carried on continuously or regularly.

While Jensen is GST registered, the subdivision activity was not an activity carried on in the course or furtherance of his taxable activity of ventilation maintenance. It was not done as part of his business and had no connection with it.

Example | Tauira 2B – Subsequent sale of residence

Jensen from Example | Tauira 2 lived in his new house for a few months before deciding to sell it to move to the United States to expand his business.

Is the later sale of his house relevant when determining whether his subdivision project is a taxable activity?

GST treatment

No, the sale of Jensen's house is not relevant when determining whether his subdivision project is a taxable activity. The subdivision, development, and building of Jensen's house was not part of an activity involving, or intending to involve, the supply of goods for consideration. It was not until after the activity concluded that the intention to sell the house formed.

If the intention to sell both houses formed earlier in the project, the work done on Jensen's house after that point would need to be considered. There are many variables that could affect whether this would be enough to be a taxable activity, but the sale of two lots means more relevance would be placed on the level of activity than in Example | Tauira 2, where only one lot was sold.

Example | Tauira 3 – Subdivision and large development

Manaia is not registered for GST. They inherited a run-down block of farmland from a relative years ago. After retiring, they take the opportunity to get the land in good working order, including renovating the farmhouse, with the intention of keeping some animals and running a lifestyle block. However, part-way through renovation, Manaia decides instead to move closer to their elderly mother who has fallen ill. While the exterior and roof still need work, the kitchen and bathroom have been completely upgraded and a dividing wall has been removed to make the living area open plan.

Given the location of the land, Manaia, who has received several enquiries from developers, knows the land would be perfect for extending a new housing development in the area.

Rather than selling the land to another developer, Manaia decides to subdivide the land and sell the lots directly to potential owner-occupiers looking to build. Manaia:

- arranges for a surveyor to prepare a site plan;
- obtains the necessary approvals from the local council;
- engages contractors to construct a new road and driveways, and to level parts of the terrain to enable foundations to be laid; and
- organises the installation of water and power infrastructure.

The land is subdivided into six lots, one of which contains the partially renovated farmhouse. As Manaia is busy looking after their mother, work on the project continues on and off over three years. After new titles are issued, four of the new lots are sold but Manaia is unable to sell the others due to a recent downturn in the market.

Is Manaia carrying on a taxable activity for GST purposes?

GST treatment

Yes, Manaia is carrying on a taxable activity of subdivision. While the level of development work is similar to that in Example | Tauira 1, the number of lots created is a distinguishing factor. As the subdivision involved the intention to supply six lots, it is very likely to be continuous or regular. The level of activity, the large scale, and corresponding cost, time and effort are relevant factors. Work on the final two lots is relevant even though they have not yet sold. Any renovation work on the farmhouse done after the intention to subdivide and sell arose is also relevant.

The length of time taken and the fact the work was done on-and-off does not mean the activity was not carried on continuously, as Manaia always intended to complete the project and it did not cease at any point. The activity was more than intermittent or occasional.

Example | Tauira 4 – Part of existing taxable activity

Loammi and Marissa are GST registered as a partnership with a taxable activity of residential property development. They buy dilapidated houses and renovate them to sell for a profit. When considering purchasing an old dwelling in Island Bay, Loammi realises that with the large backyard, she and Marissa could make a greater profit if they subdivided the land before sale. They purchase the property and begin work.

Loammi and Marissa focus most of their time and money on renovating the existing dwelling, and do only the minimum required to get resource consent and approval from Wellington City Council for the subdivision. Once they obtain a certificate for the new lot, they manage to secure a quick sale, which helps them fund the remainder of the renovation work on the dwelling.

Is the sale of the subdivided lot a taxable supply for GST purposes?

GST treatment

Yes, the sale of the subdivided lot is a taxable supply for GST purposes. Even though the level of work, effort, and cost involved in the subdivision was relatively low, and the subdivision and sale would not be a taxable activity on its own (ignoring the wider renovation project), the subdivision was done in the course or furtherance of Loammi and Marissa's existing taxable activity of property development.

Example | Tauira 5 – Regularly subdividing land

Mario-Ken discovers he can make a good profit from subdividing beachfront land, as prices are getting cheaper due to coastal erosion and global warming. He buys a parcel of land, subdivides it in two, carrying out no development on the land beyond installing water and creating easements for stormwater discharge, and then sells the bare lots.

Mario-Ken makes a good profit from the sales, so he decides to buy another lot further down the coast and subdivides it for sale, using the profits from his last subdivision to help fund the purchase. A year later he finds a good price on the neighbouring lot and subdivides it into three, again doing little development work and selling the subdivided land.

Is Mario-Ken carrying on a taxable activity?

GST treatment

Yes, Mario-Ken is carrying on a taxable activity. Even though the first subdivision would likely not be enough on its own to be a taxable activity, the repeating pattern of buying and subdividing land indicates the activity is one carried on regularly.

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Case T40 (1997) 18 NZTC 8,267

Case T62 (1998) 18 NZTC 8,468

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https://www.taxtechnical.ird.govt.nz/standard-practice-statements/general/sps-1803-effective-date-of-gst-registrations

Tax technical website (Inland Revenue, 2024)
www.taxtechnical.ird.govt.nz

TECHNICAL DECISION SUMMARIES

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TDS 24/13: GST – supply of accommodation

Decision date | Rā o te Whakatau: 18 December 2023

Issue date | Rā Tuku: 11 June 2024

Subjects | Kaupapa

GST: commercial dwelling; residential establishment; domestic goods and services; input tax deduction; zero-rated for the sale of land

Taxation laws | Ture tāke

All legislative references are to Goods and Services Tax Act 1985 (GSTA) unless otherwise stated.

Facts | Meka

1. The Arrangement involves Company A purchasing land (the Land) with an existing structure, demolishing the existing structure and constructing a building (the Building). Company A has incurred costs in relation to the Building, including for consultants, consenting, demolition and construction (Project Costs).
2. The original intent was to construct a building specifically designed to be used as a hostel. However, the Building was redesigned and reconfigured for use in providing a different kind of shared residential accommodation that targets long-term stays, but short-term stays will also be offered.
3. Upon completion, the Building will be leased to an associated person, Company B, at a market rate. Company B will be responsible for the operation and management of the Building through a Building Manager, acting as agent of Company B.
4. Both companies are Applicants in this ruling and are both registered for GST on an invoice basis.
5. The occupants of the Building will be a mix of short-term occupants (ie occupants who stay for less than 4 weeks) and longer-term occupants (ie occupants who stay for 4 or more weeks in total).
6. For the longer-term occupants, a "boardinghouse tenancy agreement" for the purposes of Part 2A of the Residential Tenancies Act 1986 will be entered into, containing the required terms as prescribed by that Act, including the quiet enjoyment of a particular unit or bedroom and the right to enjoy the communal facilities.
7. The weekly or daily charges for a unit in the Building will include the charge for the supply of accommodation, power, heating, Wi-Fi, water and the use of communal facilities, such as shared kitchen, bathrooms, laundry and other communal entertainment areas (Regular Accommodation Charges). Additional services, such as laundry or linen service, food-ordering services and on-site cafes and restaurants, will be charged separately (Additional Services).

Issues | Take

8. The main issues considered in this ruling were:
    - whether the Building is a "commercial dwelling" as defined in s 2 and, therefore, not treated as an exempt supply under s 14(1)(c)-(d);
    - whether the concessionary rate of 9% under s 10(6) applies to the supply of accommodation and the communal facilities in the Building;

- whether the input tax incurred in relation to the Project Costs and the leasing of the Building is deductible and whether an adjustment under ss 21-21HB is required;
- if Company A sells the Land, Building and all of its contents as a whole to an unrelated third party, whether that supply is to be zero-rated under s 11(1)(mb).

Decisions | Whakatau

9. The Tax Counsel Office (TCO) decided that:
   - the Building is a "commercial dwelling" as defined in s 2 and, therefore, not treated as an exempt supply under s 14(1)(c)-(d);
   - section 10(6) will apply to reduce the amount of GST on the Regular Accommodation Charges to 9% in certain circumstances;
   - the input tax incurred in relation to the Project Costs is deductible and an adjustment under ss 21-21HB is not required;
   - if Company A sells the Land, Building and all of its contents as a whole to an unrelated third party, that supply must be zero-rated under with s 11(1)(mb) if the requirements of that provision are met.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Commercial dwelling

10. Under s 14(1)(c)-(d), a supply of accommodation in a "dwelling" is an exempt supply.
11. "Dwelling" is defined in s 2. A "dwelling" excludes a "commercial dwelling". Therefore, if the Building is a "commercial dwelling", then the Building is not a "dwelling" and the supply of accommodation in the Building is not at exempt supply.
12. A "commercial dwelling" is relevantly defined in s 2 to mean a hotel, motel, homestay, farmstay, bed and breakfast establishment, inn, hostel, or boardinghouse, or a similar kind to the type of premises listed.
13. TCO considered the different types of premises and concluded that the Building is similar to a boardinghouse for the purposes of the "commercial dwelling" definition.
14. From case law, it was determined that a boardinghouse will usually have the following features:[1]
    - It will provide shared accommodation for a number of separate occupants.
    - Occupants will usually stay on a short-term basis of weeks or months, although some occupants may stay on a longer-term basis.
    - It will provide lodging (as opposed to tenancy) and may also provide board (such as, meals).
    - It will have common areas, such as shared communal kitchens, bathrooms, and living areas.
    - There will be a high level of control or management by the owners, and often the owners will live on site.
    - It will involve the provision of cleaning and maintenance services.
15. TCO considered that while the Building is not a boardinghouse, it shares many of the same features as a boardinghouse, in particular:
    - The scale of the shared accommodation in the Building will provide for a number of separate occupants.
    - Each unit will be under a separate occupancy agreement.
    - Occupants are expected to be a mix of short-term and long-term occupants.
    - Rent is to be paid weekly or sometimes daily depending on the length of stay. Weekly charges will be at least 40% higher than rent for accommodation only in a similar sized room.
    - Significant communal facilities are available for all guests to use, which are paid for as part of the rent.
    - The Building Manager will exercise significant control over the premises and the outer door of the Building through or by, a full-time onsite manager, reception desk and concierge, security resource, setting house rules to govern the use of the premises and the provision of services.

[1] *Case L75* (1989) 11 NZTC 1,435; *Case Q46* (1993) 15 NZTC 5,227; *Karmel & Co Pty Ltd (As Trustee for Urbanski Property Trust) v FCT* [2004] AATA 418; [2004] ATC 2075.

- The Building Manager is responsible for all facility maintenance of the premises, and cleaning of the exterior of the premises and communal facilities.
- Despite the occupant's right to the quiet enjoyment of their unit, the Building Manager has the discretion to relocate occupants to a comparable unit when necessary.

16. Therefore, it was concluded that the Building meets the definition of "commercial dwelling". Thus, it is not a "dwelling" and the supply of accommodation in the Building will not be exempt supplies under s 14(1)(c)-(d).

Issue 2 | Take tuarua: Reduced GST rate in s 10(6)

17. Under s 10(6), when individuals occupy a "commercial dwelling" for more than 4 weeks, a reduced effective GST rate of 9% applies to that part of the occupancy. That is, the first 4 weeks of occupancy will be subject to GST at the standard rate and the periods that occur subsequently will be subject to GST at the reduced rate.
18. The proviso to s 10(6) (the Proviso) extends this concessionary treatment to apply the reduced rate from the start of the occupancy. The Proviso applies when the following requirements are met:
    - The supply is a supply of domestic goods and services;
    - The domestic goods and services are supplied in a commercial dwelling that is residential establishment; and
    - The supplier and the recipient have agreed that the supply of domestic goods and services will be for a period of 4 or more weeks in total.

Domestic goods and services

19. The term "domestic goods and services" means the right to occupy all or part of a commercial dwelling, including the following services where they are provided as part of the right to occupy:
    - cleaning and maintenance;
    - electricity, gas, air-conditioning, or heating;
    - telephone, television, radio, or any other similar chattel.
20. Considering the components of the Regular Accommodation Charges, TCO concluded that the supplies covered by the Regular Accommodation Charges will be domestic goods or services because:
    - The accommodation charge gives the person the right to occupy a unit in the Building.
    - Power and heating are items listed in the definition.
    - Water and Wi-Fi are facilities that are part of a person's enjoyment of their right to occupy a unit in the Building and are considered supplies of domestic goods and services.
    - The right to use the applicable communal facilities is also considered to be a supply of domestic goods and services because the use of the communal facilities naturally goes with occupying a unit in the Building. It is not an optional or additional service as part of the person's occupation and enables a person's enjoyment of their right to occupy the Building.
21. The supplies included in the Additional Services, however, are not supplies of domestic goods or services. The Additional Services are optional services that are not necessary to enable a person's enjoyment of their right to occupy the Building.
22. Therefore, the first requirement in the Proviso is met.
23. The third requirement in the Proviso will also be met where there is an agreement with longer term occupants that they will stay for 4 weeks or more in total.
24. Thus, the remaining issue to be considered is whether the Building will be a "residential establishment".

Residential establishment

25. "Residential establishment" is defined in s 2. In relation to the Building, the definition relevantly requires that:
    - The Building is a "commercial dwelling". This requirement is met, as concluded in Issue 1.
    - There is a supply of "domestic goods and services". This requirement is met as concluded above.
    - At least 70% of the individuals to whom "domestic goods and services" will be supplied must be expected to reside in the Building for 4 or more weeks.

70% of individuals expected to stay for 4 weeks or more

26. As mentioned in the Facts, the occupants of the Building will be a mix of short-term stays of less than 4 weeks and longer-term stays of 4 weeks or more. Therefore, it is expected that there will be periods where the requirement that 70% of occupants will stay, or are expected to stay, for 4 or more weeks in total (the Qualifying Periods) will be met, and periods where this 70% threshold will not be satisfied.
27. TCO considered that the Building will satisfy the s 2 definition of "residential establishment" during each Qualifying Period, even though the longer-term occupancy rate may fall below 70% from time to time.
28. Therefore, the Proviso will apply to a supply of "domestic goods and services" in the Building which commences in periods when the Building satisfies the "residential establishment" definition and the occupant has agreed to stay for a period of 4 or more weeks in total.
29. However, the "residential establishment" definition will not be met, and therefore the Proviso will not apply, in periods where the long-term occupancy rate falls below 70%.

Overall conclusion

30. Consequently, TCO concluded that s 10(6) will apply to reduce the amount of GST on the Regular Accommodation Charges to 9%:
    - from the day that the occupancy commences for a longer-term occupant who in the occupancy agreement has agreed to stay for 4 or more weeks in total and who commences their occupancy during a period in which the Building is a "residential establishment" as defined in s 2; or
    - for any other occupancy agreement, for the period that commences after the occupant has resided in the Building for a period of 4 weeks.
31. For the avoidance of doubt, the following supplies will be subject to GST at 15% on the full consideration charged:
    - the first 4 weeks of any occupancy agreement entered into where one or both of the following is true:
      - the Building is not a "residential establishment";
      - the occupant has not agreed to stay for 4 weeks or more.
    - any separate charges for non-domestic goods and services, such as charges for the Additional Services.

Issue 3 | Take tuatoru: Input tax deductions and adjustments

32. In this issue, TCO considered whether the input tax incurred in relation to the Project Costs is fully deductible.
33. Under s 20(3), the input tax that a registered person has paid when acquiring goods and services may be offset against the GST output tax charged on supplies made by the person in the same period.
34. For the Applicants to claim input tax, the following requirements must be met:
    - There is an amount of output tax;
    - There is an amount of input tax that relates to a supply of goods and services made to the registered person during the taxable period, to the extent those goods or services are used for making taxable supplies.

Output tax

35. Output tax is charged on the supply of goods and services (but not including an exempt supply) by a registered person in the course or furtherance of a taxable activity carried on by that person (s 8).
36. After concluding that the provision of the accommodation, communal facilities and Additional Services in the Building will be supplies of goods or services in a commercial dwelling that are not exempt supplies, TCO considered if those supplies are in the course or furtherance of a taxable activity.
37. "Taxable activity" is defined in s 6. There are four requirements that must be satisfied to show there is a taxable activity under s 6(1)(a):
    - There must be an activity.
    - The activity must be carried on continuously or regularly by a person.
    - The activity must involve, or be intended to involve, the supply of goods and services to another person.
    - The supply or intended supply of goods and services must be for a consideration.

38. In addition, s 6(2) states that anything done in connection with the beginning or ending of a taxable activity is to be treated as being carried out in the course or furtherance of that taxable activity.
39. TCO concluded that any supplies of goods and services to be made by the Applicants in relation to the Building will be made in the course or furtherance of a taxable activity because:
    - The Applicants are carrying on the activity of providing accommodation and other facilities to the occupants of the Building.
    - The scale of the Building project and the commercial nature of the Building involve a series of acts. The supply of accommodation and facilities in the Building will form a definite course of action which the Applicants carry on recurrently and at uniform intervals.
    - The occupants will pay rent to the Applicants as consideration for the supply of the accommodation and facilities in the Building.
40. Further, it was also considered that the activities relating to the construction of the Building and the leasing of the Building to Company B are carried out in connection with the beginning of the activity to supply residential accommodation and facilities in connection with the Building. As such, it was concluded that these activities are treated as being carried out in the course or furtherance of the Applicants' taxable activity of providing accommodation and facilities in the Building.
41. Consequently, the Applicants will be required to charge tax under s 8(1) when it starts using the Building to make supplies of accommodation, which will qualify as "output tax" as defined in s 2.

Input tax

42. Section 20(3C) provides that input tax may be deducted to the extent to which the goods or services are used for, or are available for use in, making taxable supplies.
43. TCO considers that a property intended for making taxable supplies, but which is not actively being used, is available for making future taxable supplies if there is a well formulated plan for an intended future use that gives a reasonable result.
44. Further, under s 20(3G), a person must estimate, at the time of acquisition, the percentage of total use for which goods or services will be used for making taxable supplies. This determines whether apportionment of the input tax is required.
45. TCO concluded that, prior to the active use of the Building, Company A is entitled to fully deduct the input tax component of the Project Costs at the time of acquisition, both prior to reconfiguring the Building and subsequently because:
    - There was a well formulated plan in place for the intended use of the Building that will give a reasonable result. Therefore, the goods and services related to the Project Costs are "available for use" in making taxable supplies, even though the construction of the Building was not yet completed.
    - The intended use of the goods or services reflected in the Project Costs were 100% used for making taxable supplies and the change in the configuration from a hostel to another kind of shared accommodation did not alter this percentage. Therefore, no apportionment is required.

Subsequent adjustments

46. As there was a change in the intended use of the goods or services relating to the Project Costs (ie reconfiguring the Building from a hostel to another kind of shared accommodation), TCO considered if an adjustment to input tax in relation to the Project Costs is required under ss 21-21HB.
47. A registered person is required to adjust their input tax if there is a percentage difference between the "percentage actual use" (ie, the extent to which the goods or services are actually used for making taxable supplies) and, relevantly, the "percentage intended use" (ie, the percentage estimated at the time of acquisition under s 20(3G)).
48. TCO concluded that no adjustment is required because the "percentage intended use" and the "percentage actual use" of the goods and services reflected in the Project Costs are both 100% for taxable supplies. That is, both the hostel configuration (intended use) and the revised shared accommodation configuration (actual use) are fully taxable supplies of accommodation in a commercial dwelling.

Issue 4 | Take tuawhā: Zero-rating under s 11(1)(mb)

49. For the sale of the Land and the Building to be zero-rated, the requirements of s 11(1)(mb) must be satisfied:
    - There must be a supply.
    - The supply must consist wholly or partly of land.
    - The supply of land must be a supply that is made by a registered person to another registered person.
    - The other registered person must acquire the goods with the intention of using them for making taxable supplies.
    - The supply of land must not be intended to be used as a principal place of residence of the recipient of the supply or a person associated with them under s 2A(1)(c).
50. TCO concluded that the supply of the Land, Building and all of the contents must be zero-rated in accordance with s 11(1)(mb) in these circumstances:
    - if the Applicant sells the Land, Building and all of the contents as a whole to an unrelated third-party purchaser who is a registered person and who acquires that property with the intention of using it to make taxable supplies; and
    - it is not a supply of land intended to be used as a principal place of residence of the recipient of the supply or a person associated with them.

TDS 24/14: Interest free loan and dividends

Decision date | Rā o te Whakatau: 13 October 2023

Issue date | Rā Tuku: 3 July 2024

Subjects | Kaupapa

Income tax: capitalisation of company structure; interest free loan whether a dividend arises; withholding tax; tax avoidance

Taxation laws | Ture tāke

All legislative references are to the Income Tax Act 2007 (the Act) unless otherwise specified.

Facts | Meka

1. This ruling involved the steps by which Company A is funded to enable its wholly owned subsidiary (Company B) to settle the sale and purchase of certain assets in New Zealand from a third-party.
2. Company A was incorporated in New Zealand by Company C (a non-resident company) with nominal equity. Following its incorporation, Company A acquired all the shares in Company B from Company C in consideration for Company A issuing shares to Company C.
3. The Arrangement includes an interest-free shareholder loan from Company C to Company A and the ongoing repayments of that loan.

Issues | Take

4. The main issues considered in this ruling were:
   - whether the interest free loan gave rise to dividends to Company C from Company A;
   - whether repayment of the interest free loan was subject to withholding; and
   - whether ss BG 1 and GA 1 apply to negate the outcomes of the above two issues.

Decisions | Whakatau

5. The Tax Counsel Office (TCO) concluded that:
   - the interest free loan from Company C to Company A does not give rise to a dividend from Company A to Company C under s CD 1 at any point in time, including as a result of the issue or repayment of the loan;
   - Company A is not required to withhold or pay an amount of tax under s RA 6 in relation to the interest free loan repayments made to Company C; and
   - sections BG 1 and GA 1 do not apply to negate or vary the above two tax outcomes.
6. The following condition was included:
   - The only amounts payable under the interest free loan are the lending of the NZD principal by Company C as lender and the repayment of the NZD principal by Company A as borrower.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Whether the interest free loan gave rise to dividends (s CD 1)

7. Section CD 3 provides that ss CD 4 to CD 20 define what is a dividend for tax purposes.
8. Relevantly, the interest free loan provided by Company C would give rise to a dividend under s CD 4 if:
   - there was a "transfer of company value" from a "company" to a person.
   - the cause of the transfer is a "shareholding in the company".
   - none of the exclusions in ss CD 22 to CD 37 apply to the transfer.

9. Under s CD 5, a transfer of company value from a company to a person occurs when:
    - the company provides money or money's worth to the person; and
    - if the person provides any money or money's worth to the company under the same arrangement, the market value of what the company provides is more than the market value of what the person provides.
10. The following cashflow would arise on the interest free loan:
    - Company C will be providing principal to Company A.
    - Over time, Company A will repay the principal lent by Company C.
11. Accordingly, there would be no net cashflow under the interest free loan. However, there is a time value to money. The market value of what Company C is providing to Company A, may exceed the market value of what Company A would provide in the future. That the provision of money (a loan) at below market interest rates can give rise to a dividend is illustrated by s CD 39 which applies to determine the amount of a dividend that arises because a company makes property available to a person. The deemed dividend is calculated by reference to a benchmark rate of interest.
12. However, any net transfer of value resulting from the interest free loan would arise to Company A (who would benefit from the below market interest rate), not Company C.
13. Therefore, it was concluded that Company C does not derive a dividend from making the interest free loan to Company A.
14. Given the conclusion in [13] above, TCO also considered the dividend implications for Company A. This required TCO to consider whether the transfer of value from Company C to Company A was caused by a shareholding relationship.
15. Section CD 6 states that a transfer of value by a company (Company C) to a person (Company A) will be "caused by" a shareholding relationship if the recipient (Company A) holds shares in the company (Company C), or is associated with a shareholder, and the company (Company C) makes the transfer because of that shareholding.
16. TCO determined that Company A did not hold shares in Company C, but they were associated companies which meant the relevant shareholding relationship did exist.
17. TCO noted that s CD 4(1)(b) provided that a transfer of company value from a company to a person is a dividend if none of the exclusions in ss CD 22 to CD 37 applied.
18. It was found that the exemption in s CD 27(3) applied because the three cumulative requirements were satisfied:
    - Company C, being the "first company", had a voting interest in Company A, being the "associated company": para (a)(i).
    - Company A, being the "associated company" does not have a voting interest in Company C, being the "first company": para (b).
    - No person, other than the parent company of Company C (Company D) had both a voting interest or market value interest in Company C and Company A (as the "associated company"). Company C is a wholly owned subsidiary of Company D. Company C and Company D were both not resident in New Zealand, and therefore Company D could have received the transfer of company value without it being assessable income or non-resident passive income.

Other rules

19. TCO also considered whether any of the following rules applied:
    - financial arrangements rules;
    - recharacterisation provisions;
    - hybrid mismatch rules;
    - transfer-pricing regime.
20. TCO concluded that none of the above applied to affect the outcome.

Conclusion of issue 1

21. TCO concluded that the interest free loan from Company C to Company A did not give rise to a dividend from Company A to Company C under s CD 1 at any point in time, including as a result of the issue or repayment of the loan.
22. The conclusion was subject to the condition that the only amounts payable under the interest free loan were the lending of the NZD principal by Company C as lender and the repayment of the NZD principal by Company A as borrower.

Issue 2 | Take tuarua: Whether repayment of the interest free loan is subject to withholding (s RA 6)

23. Section RA 6 concerns withholding and payment obligations for passive income. Section RA 6(2) applies to a person who makes a payment of non-resident passive income under subpart RF. That person must withhold and pay tax to the Commissioner. This is relevant to the future interest free loan repayments which will be made by Company A to Company C.

24. Section RF 1(2) provides that the NRWT rules apply to a person who pays an amount of non-resident passive income. Section RF 2 defines "Non-resident passive income."

25. For the reasons discussed above, the interest free loan repayments made by Company A to Company C would not constitute a dividend (para (a) of s RF 2(1)) or interest (para (d)) paid to Company C.

26. The interest free loan repayments do not constitute royalties (para (b)) or investment society dividends (para (c)).

27. Non-resident financial arrangement income (NRFAI) is defined in s RF 2C. In short, it is clear the interest free loan repayments would not constitute NRFAI (para (e)) as no interest is paid on the loan that would otherwise be subject to NRWT absent the NRFAI rules applying. Nor does any financial arrangement expenditure arise in respect of the interest free loan which means there is no deferral of NRWT.

28. Accordingly, the repayment of the interest free loan by Company A to Company C would not constitute a payment of non-resident passive income. Company A would not be required to withhold under s RA 6(2).

Conclusion of issue 2

29. Company A would not be required to withhold or pay an amount of tax under s RA 6 in relation to the interest free loan repayments made to Company C.

Issue 3 | Take tuatoru: Whether s BG 1 applies

30. Section BG 1(1) provides that a "tax avoidance arrangement" is void as against the Commissioner. Section GA 1 enables the Commissioner to make an adjustment to counteract a tax advantage obtained from or under a tax avoidance arrangement.

31. The Supreme Court in *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115, [2009] 2 NZLR 289 considered it desirable to settle the approach to applying s BG 1. This approach is referred to as the Parliamentary contemplation test, which is an intensely fact-based inquiry. *Ben Nevis* has been followed in subsequent judicial decisions.

32. The Tax Counsel Office's approach in making this decision is consistent with Interpretation Statement: IS 23/01 Tax avoidance and the interpretation of the general anti-avoidance provisions sections BG 1 and GA 1 of the Income Tax Act 2007 (3 February 2023) (IS 23/01). IS 23/01 will not be replicated in this TDS but in summary the steps are as follows:
    - Understanding the legal form of the arrangement. This involves identifying and understanding the steps and transactions that make up the arrangement, the commercial or private purposes of the arrangement and the arrangement's tax effects.
    - Determining whether the arrangement has a tax avoidance purpose or effect. This involves:
        - Identifying and understanding Parliament's purpose for the specific provisions that are used or circumvented by the arrangement.
        - Understanding the commercial and economic reality of the arrangement as a whole by using the factors identified by the courts. Artificiality and contrivance are significant factors.
        - Considering the implications of the preceding steps and answering the ultimate question under the Parliamentary contemplation test: Does the arrangement, when viewed in a commercially and economically realistic way, make use of or circumvent the specific provisions in a manner consistent with Parliament's purpose?
    - If the arrangement has a tax avoidance purpose or effect that is not the sole purpose or effect of the arrangement, consider the merely incidental test. The merely incidental test considers many of the same matters that are considered under the Parliamentary contemplation test.

33. Taking into account all of the relevant facts and circumstances (noting that as this is a summary it may not contain all the facts or assumptions relevant to the decision and, therefore, cannot be relied on) the Tax Counsel Office concluded as follows.

The arrangement

34. The Arrangement is the steps by which Company A is capitalised and funded to enable its wholly owned subsidiary to settle the sale and purchase of certain assets and the on-going repayment of the interest-free shareholder loan from Company C (a non-resident company) to Company A.

35. The tax effects in respect of the interest-free loan are:
    - For the lender Company C:
        - No dividend income will arise under s CD 1.
        - No interest income will arise under s CC 4.
        - No financial arrangements income will arise under subpart EW and s CC 3.
        - No withholding will be required under s RA 6 from the repayments of the money lent by Company A.
    - For the borrower Company A:
        - No dividend income will arise under s CD 1.
        - No financial arrangements income or deductible expenditure will arise under subpart EW, ss CC 3, DB 6 or DB 7.
36. The tax effects pertaining to the interest free loan did not raise any s BG 1 concerns as the applicable legislative provisions were working as intended. There was no artificiality or circular money flows.

Parliamentary contemplation

37. It was clear from the Act that Parliament contemplated funds could be provided by way of interest free loans, made by a non-resident lender into New Zealand. It was also clear that the focus in the Act is on actual payments and net gains and losses, not the return of money lent. While various provisions are aimed at ensuring excessive interest deductions are not taken in New Zealand, there are no provisions seeking to create income where no amount is actually paid over and above the return of money lent.
38. Considering the above, TCO concluded that the repayment of money lent which does not give rise to income for the lender, did not raise any concerns from a tax avoidance perspective. The legislation was working as intended and the tax effects would be within Parliament's contemplation.
39. TCO discussed the distinction between debt and equity noting that for example, non-participating redeemable preference shares may be considered, in substance, to be very similar to a loan. However, where funds are contributed whether by way of debt or equity, the return of the funds can be made tax free.
40. The main difference was about the relative ease of returning the original funds. From a company law perspective, it is easier to repay or restructure debt than it is to return equity. From a tax perspective, the repayment of money lent is not taxable. The same is generally true for shares, but there are additional statutory requirements which revolve around the statutory notion of available subscribed capital which can be returned without being treated as a dividend.
41. TCO concluded that whether funds are contributed by way of debt or equity, Parliament contemplated that funds could be returned tax free as it is not a net gain that should be taxable as income. However, there are more restrictions when returning share capital.
42. Additionally, as the Arrangement would involve significant offshore lending to a New Zealand company, TCO also considered the thin capitalisation rules in subpart FE.
43. TCO noted that interest free loans are excluded from the definition of "group debt" in s FE 15, as they do not give rise to amounts that are deductible. Interest free loans are also excluded from the calculation of "non-debt liabilities" under s FE 16B.
44. It was clear that the thin capitalisation rules treat interest free loans as being akin to equity, in a manner which is consistent with other parts of the Act.
45. Accordingly, TCO concluded that the provisions of the Act were being used for the effect that Parliament intended. The Arrangement's interaction with the thin capitalisation rules did not raise any avoidance concerns.

Commercial and economic reality

46. There was nothing in the context of this Arrangement to suggest that, in commercial and economic reality, Company A should be treated as paying a net positive amount rather than returning the funds provided by way of the interest free loan.

Conclusion

47. Accordingly, TCO considered the provisions of the Act were being used and had the effect that Parliament intended. The above analysis indicated that it is likely that Parliament would consider that the Arrangement makes use of the relevant provisions in a manner that is consistent with Parliament's purpose for those provisions. Therefore, the Arrangement did not have a tax avoidance purpose or effect.
48. Given the conclusion that the Arrangement is not a tax avoidance arrangement, it was not necessary for TCO to consider the application of s GA 1.

REGULAR CONTRIBUTORS TO THE TIB

Tax Counsel Office

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

Legal Services

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

Technical Standards

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

Policy and Regulatory Stewardship

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