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TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

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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).

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

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Ref	Draft type	Title	Comment deadline
PUB00455	Interpretation statement	Look-through companies and disposal of residential land under the bright-line test	23 September 2024
PUB00454	Interpretation statement	Income Tax – Share investments	24 September 2024

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IN SUMMARY

New legislation

SL 2024/154– Order in Council Double Tax Agreements (Slovak Republic) Order 2024 2

These regulations incorporate into New Zealand law a new double tax agreement between New Zealand and the Slovak Republic. These regulations come into force on 29 August 2024.

SL 2024/153 – Order in Council Double Taxation Relief (Austria) Amendment Order 2024 3

These regulations incorporate into New Zealand law a protocol to the existing double tax agreement between New Zealand and Austria. These regulations come into force on 29 August 2024.

Legislation and determinations

DET 24/03: Determination under section RD 11(3) of the Income Tax Act 2007 of the amount of tax for a payment of a main benefit 4

This determination, made under s RD 11(3) of the Income Tax Act 2007, sets the PAYE tax rates that apply to main benefits paid by the Ministry of Social Development.

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This interpretation statement explains an employer's withholding and reporting obligations related to PAYE, student loans and KiwiSaver if an employer wants to fund the cost of tax (and student loan, if applicable) on an employee share scheme benefit provided in shares.

Commissioner's statement

CS 24/01: Determining the "market value" of shares that an employee receives under an employee share scheme 47

This statement provides guidance on working out the market value of a share benefit that employees receive under an employee share scheme.

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SPS 24/02: Extension of time applications from customers without tax agents 71

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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.

Double Tax Agreements (Slovak Republic) Order 2024

Section BH 1 of the Income Tax Act 2007

Order (SL 2024/154)

These regulations, which come into force on 29 August 2024, implement, into New Zealand law, the *Agreement between New Zealand and the Slovak Republic for the Elimination of Double Taxation with Respect to Taxes on Income and the Prevention of Tax Evasion and Avoidance*. The Agreement itself will come into force following an exchange of diplomatic notes, with it taking effect according to the Agreements' provisions after that.

Background

New Zealand has a network of 40 double tax agreements (DTAs). DTAs are designed to reduce double taxation, increase tax certainty and minimise other tax impediments to cross-border economic activity and investment.

On 26 September 2023, New Zealand signed the *Agreement between New Zealand and the Slovak Republic for the Elimination of Double Taxation with Respect to Taxes on Income and the Prevention of Tax Evasion and Avoidance* (the Slovak DTA).

A key reason for negotiating the Slovak DTA was that the Slovak Republic is a member of the European Union (EU), and New Zealand has recently negotiated a Free Trade Agreement (FTA) with the EU. DTAs can help maximise the benefits of FTAs. The Slovak Republic, like New Zealand, is also a member of the Organisation for Economic Co-operation and Development (OECD), which expressly recommends DTAs be negotiated between its members.

Key features

The Slovak DTA broadly follows international norms for double tax agreements. Key features for taxpayers include:

- Lower withholding tax rates, providing certainty and reduced tax compliance costs for investors in both jurisdictions. These rates will be lower than those provided to investors from jurisdictions without a DTA.
- A Mutual Agreement Procedure article to facilitate the resolution of tax disputes (including in complex areas such as transfer pricing).
- Reduced tax compliance and cash-flow advantages for taxpayers engaged in certain short-term cross-border activities by eliminating the need to pay tax in the other jurisdiction and then claim that tax back in their home jurisdiction.
- All major base erosion and profit shifting (BEPS) model anti-abuse provisions, developed by the OECD. This will help ensure that the DTA is not used to reduce taxation in unintended ways.
- An equitable framework for sharing the costs of relieving double taxation between New Zealand and the Slovak Republic.

Effective date

The Double Tax Agreements (Slovak Republic) Order 2024 entered into force on 29 August 2024. The DTA will enter into force through the exchange of diplomatic notes between the Slovak Republic and New Zealand. The provisions of the agreement will take effect as per the agreed terms in the text.

Further information

The new regulations can be found at:
https://www.legislation.govt.nz/regulation/public/2024/0154/latest/whole.html#LMS977814

The Select Committee report, including the National Interest Analysis on the Slovak DTA, can be found at:
https://selectcommittees.parliament.nz/v/6/21453827-98a1-477a-04ef-08dc492eca7f

Double Taxation Relief (Austria) Amendment Order 2024

Section BH 1 of the Income Tax Act 2007

Order (SL 2024/153)

These regulations, which come into force on 29 August 2024, implement, into New Zealand law, the *Second Protocol to the Agreement between New Zealand and the Republic of Austria with respect to Taxes on Income and on Capital*. The Protocol itself will come into force after the exchange of diplomatic notes.

Background

New Zealand has a double tax agreement (DTA) with Austria, the *Agreement between New Zealand and the Republic of Austria with respect to Taxes on Income and on Capital*. It was signed in Vienna on 21 September 2006.

The existing DTA contains a most-favoured nation (MFN) clause relating to withholding tax rates on investment income. New Zealand triggered this clause after agreeing to reduce withholding rates with Australia and the United States.

Subsequently, New Zealand and Austria entered into negotiations on a new Protocol to amend the existing DTA to honour the MFN obligations. New Zealand was required to enter into negotiations with Austria with a view to providing lower withholding rates on investment income.

In addition to the MFN obligation, Austria and New Zealand took the opportunity to update the existing DTA in several other respects.

Key features

The key changes to the existing DTA introduced by the Protocol are:

- Reducing the withholding tax rates on dividends from 15% to either 5% or 0%, when certain conditions (such as a minimum holding size) are met.
- Narrowing the scope of the MFN clause going forward so that it only applies in respect of New Zealand's DTAs with other European Union countries, rather than other OECD countries.
- Inserting a package of new model anti-treaty abuse provisions that have been developed as part of the base erosion and profit shifting (BEPS) work undertaken by the OECD. This will help ensure that the DTA is not used to reduce taxation in unintended ways.
- Inserting a new Assistance in Collection of Taxes article, which will enable both Austria and New Zealand to request administrative assistance from each other in the collection of taxes in default.

A number of minor and administrative changes were also made, which for the most part will not affect taxpayers.

Effective date

The Double Taxation Relief (Austria) Amendment Order 2024 entered into force on 29 August 2024. The Protocol itself will enter into effect after the exchange of diplomatic notes between Austria and New Zealand, which we expect to occur shortly.

Further information

The new regulations can be found at:

https://www.legislation.govt.nz/regulation/public/2024/0153/latest/whole.html#LMS977759

The Select Committee report, including the National Interest Analysis on the Protocol, can be found at:

https://selectcommittees.parliament.nz/v/6/49903540-7e47-459b-04f1-08dc492eca7f

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.

DET 24/03: Determination under section RD 11(3) of the Income Tax Act 2007 of the amount of tax for a payment of a main benefit

Issued: 10 July 2024

EFFECTIVE: for the 2024-25 income year onwards.

Determination

The Commissioner of Inland Revenue, under section RD 11(3) of the Income Tax Act 2007, has determined, in consultation with the Chief Executive of the Ministry of Social Development (being the administering department), the amount of tax for a payment of a main benefit as follows:

- For any payments made up to and including Thursday, 1 August 2024 - the M tax code rate set out in Commissioner's weekly PAYE tables that apply from 1 April 2024 to 30 July 2024.
- For any payments made on or after Friday, 2 August 2024 – the M tax code rate set out in the Commissioner's weekly PAYE tables that apply from 31 July 2024.

Dated at Wellington on 10 July 2024.

Matthew Evans

Technical Lead
Technical Standards, Legal Services
Inland Revenue

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

Summary of effect

1. Under s RD 11(3) of the Income Tax Act 2007 the amount of tax for a PAYE income payment that is a payment of a main benefit must be determined by the Commissioner of Inland Revenue, in consultation with the Chief Executive of the Ministry of Social Development (being the administering department).
2. A main benefit is defined in s YA 1 of the Income Tax Act 2007 as:

   main benefit means any of the following:

   (a) a main benefit, as defined in paragraph (a) of the definition of main benefit in schedule 2 of the Social Security Act 2018:

   (b) main benefit equivalent assistance

   main benefit equivalent assistance means special assistance granted under—

   (a) clause 9 of the COVID-19 New Zealanders Stranded Overseas Support Programme that corresponds to a main benefit, as defined in paragraph (a) of the definition of main benefit in schedule 2 of the Social Security Act 2018; or

   (b) clause 11 of that programme

3. The tax rate determined under s RD 11(3) is the amount of tax required to be paid to the Commissioner by the Chief Executive for a payment of a main benefit. The amount of tax calculated using this rate is paid by the Ministry of Social Development to Inland Revenue. This is not the final tax for the recipient of the main benefit; that is determined at the end of year square up for the recipient based on their total taxable income.
4. The Taxation (Budget Measures) Act 2024 amended the personal income tax thresholds from Wednesday, 31 July 2024.
5. In order to facilitate the smooth administration and taxation of main benefits in the cross-over from the current to the new personal income tax thresholds, the Commissioner has consulted with the Chief Executive and determined:
   5.1 For any payments of main benefits made up to and including Thursday, 1 August 2024, the rate of tax shall be the M tax rate set out in the Commissioner's PAYE tables that apply at the date of this determination and are set out in the applicable IR340.
   5.2 For any payments of main benefits made on or after Friday, 2 August 2024, the rate of tax shall be the M tax rate set out in the Commissioner's PAYE tables that apply the tax thresholds set out in the Taxation (Budget Measures) Act 2024 and will be set out in the applicable IR340.
6. The rate of tax determined under s RD 11(3) is not the final tax on the payment of the main benefit. The final tax is determined at the end of year square up for a recipient of the main benefit based on that person's total taxable income. Although it will depend on the total taxable income of the recipient, this may mean that a recipient will have too much PAYE tax paid for the few days between 31 July 2024 and their benefit payment the following week, although this can be reconciled and may be refundable at the end of year square up.

References

Legislative references

Income Tax Act 2007: sections RD 11(3), RA 5, RD 10, YA 1 and Schedule 2.

Social Security Act 2018: paragraph (a) of the definition of main benefit in Schedule 2.

INTERPRETATION STATEMENTS

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 24/05: Employer obligations for employee share scheme benefits paid in cash

Issued | Tukuna: 30 July 2024

This interpretation statement explains an employer's PAYE, student loan and KiwiSaver obligations when an employee receives a benefit under an employee share scheme that is paid in cash.

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

START DATE | RĀ TĪMATA

This interpretation statement applies to an employee share scheme benefit paid in cash on or after 1 November 2024.

Summary | Whakarāpopoto

1. An employee share scheme (ESS) benefit is usually provided in **shares**. In this situation, the employer can elect to withhold and pay tax on the share benefit. However, there is no requirement for the employer to withhold tax. If the employer elects to withhold tax they must also deduct student loan repayments (if any) but Accident Compensation Corporation (ACC) earners' levy and KiwiSaver do not apply.
2. The purpose of the election is to simplify tax compliance for the employee. If no election is made the employer must generally still report the value of the benefit to Inland Revenue in its employment income information (EI) and the employee pays tax on the benefit through the end-of-year tax return process. Withholding is not compulsory because of concerns that it may impose additional compliance costs on employers.[1]
3. In some circumstances, an employee may receive **cash** instead of shares under an ESS (a **cash-settled ESS benefit**). The following questions arise when an employee receives a cash-settled ESS benefit:
   - Is the employer required to withhold tax (and student loan, if any) from the benefit (on the basis that a cash benefit is an ordinary extra pay) or does the employer have the choice to withhold as they do if the benefit is provided in shares?
   - Does an employer have to withhold ACC earners' levy or have KiwiSaver obligations?
4. An employee might receive cash under a share scheme in various scenarios, such as the following:
   - The employer reserves the right to provide cash instead of shares under the terms of the scheme.
   - The employee can choose to receive cash instead of shares under the terms of the scheme.
   - The terms of the scheme include flexibility to vary the scheme and pay cash in specific situations (eg when the company is sold or an employee retires).
   - The scheme is a phantom share scheme, where amounts are always paid in cash.

1 For more information on withholding tax from an ESS benefit provided in shares see **IS 24/06: PAYE – How an employer funds the tax cost on an employee share scheme benefit**.

5. If the cash is a "benefit" under an ESS, some tax rules apply differently compared to other cash payments. Accordingly, the first step is to clarify whether the cash the employee receives is truly a cash-settled ESS benefit. This involves considering two questions:
   - Is the scheme an "employee share scheme"?
   - Does the amount give rise to a "benefit" under an ESS?
6. Broadly, the scheme will be an "employee share scheme" if it is an arrangement with a purpose or effect of issuing or transferring shares in a company to an employee. The relevant time to assess this requirement is when the scheme is entered into. The arrangement must also be connected to the employee's employment or service.
7. A phantom share scheme is an example of a scheme that is not an "employee share scheme" for tax purposes. This is because, under a phantom share scheme, an employee never becomes a shareholder in the company. The benefits are always paid out in cash. In this case, the amount will generally be an ordinary cash bonus and subject to the usual PAYE rules.
8. A cash amount will give rise to a "benefit" under an ESS if the share scheme taxing date is triggered by a transfer or cancellation of shares or related rights under the ESS and the cash is paid for this transfer or cancellation.
9. An example of an ESS where the cash amount will not generally give rise to a "benefit" under the scheme is where under the terms of the ESS the incentive is paid partly in cash and partly in shares. The part that is paid in cash is likely to be paid in satisfaction of the rights to cash granted under the scheme (ie there is no transfer or cancellation of rights to shares). In this situation, the cash amount will generally be an ordinary cash bonus and subject to the usual PAYE rules.
10. Once it has been established that a cash amount is a cash-settled ESS benefit, the following outcomes arise:
    - The cash-settled ESS benefit is an "extra pay" under the general definition of extra pay and a PAYE income payment.
    - The employer is required to withhold tax at the applicable extra pay rate (plus ACC earners' levy and student loan, if applicable).
11. The employer is not required to make KiwiSaver deductions or employer contributions on a cash-settled ESS benefit. This is because KiwiSaver deductions and contributions are based on an employee's gross "salary or wages" and a cash-settled ESS benefit is excluded from the definition of "salary or wages" for the purposes of the KiwiSaver Act 2006.
12. The election to withhold tax from an ESS benefit applies only to share-settled benefits (ie non-cash benefits). An employer cannot make an election to withhold tax (or choose not to withhold tax) where withholding is already required. This conclusion reflects the purpose of the legislation (to simplify tax compliance for an employee) and the statutory context (to tax employment income at source).
13. The key questions relevant to determining an employer's PAYE, student loan and KiwiSaver obligations for awards provided to an employee under a share scheme are summarised in Figure | Hoahoa 1, which is before the Examples | Tauira.
14. This interpretation statement does not consider the implications of any anti-avoidance provisions. The outcomes set out may not apply where the general anti-avoidance provision (s BG 1) or the specific ESS anti-avoidance provision (s GB 49B) applies.

Introduction | Whakataki

Overview of the issues

15. Most employment income or benefits are taxed at source under the PAYE or FBT rules. However, generally, employee share scheme (ESS) benefits are treated differently. While employers must report the value of the benefit in their EI return (with an exception for some former employees), they generally have a choice about whether to withhold tax under the PAYE rules. Accident Compensation Corporation (ACC) earners' levies and KiwiSaver obligations do not generally apply to ESS benefits.
16. An ESS benefit is usually provided in shares. It is clear how the PAYE rules work in relation to share-settled benefits. However, in some circumstances an employee may receive cash instead of shares. An issue arises as to whether an employer is required to withhold tax (and student loan repayments, if any) from a cash benefit (on the basis that a cash benefit is an ordinary extra pay) or has the choice to withhold as they do if the benefit is provided in shares. A related question is whether an employer has to withhold ACC earners' levy or has KiwiSaver obligations when an ESS benefit is provided in cash.
17. This interpretation statement explains the Commissioner's position on those issues. It also considers the circumstances in which a cash payment provided to an employee under an ESS is a cash-settled ESS benefit. The statement considers the following three questions:
    - What is a cash-settled ESS benefit?
    - Is an employer required to withhold tax from a cash-settled ESS benefit?
    - Is an employer required to deduct student loan repayments from a cash-settled ESS benefit?
    - What are an employer's KiwiSaver obligations for a cash-settled ESS benefit?
18. This statement only applies where the person receiving the benefit is an employee (under a contract of service).[2] It considers an employer's PAYE (including the ACC earners' levy), student loan and KiwiSaver obligations. Generally, a child support deduction notice will not apply to an ESS benefit. However, if an employer has any questions about whether to make a child support deduction, they should contact Inland Revenue. This statement does not consider child support deductions any further.

Assumptions in this interpretation statement

19. This interpretation statement focuses on whether a cash benefit received under an ESS is treated differently for PAYE, student loan and KiwiSaver purposes to a benefit received in shares. For clarity and simplicity, where a technical requirement is not directly relevant to answering this question, it is assumed that the requirement has been met or does not apply. This statement will explicitly state where such assumptions have been made.

What is a cash-settled employee share scheme benefit?

20. This interpretation statement uses the term "cash-settled ESS benefit" to describe a benefit received under an ESS that is provided in cash rather than shares.
21. Broadly, an employee might receive cash in the following situations:
    - The employer reserves the right to provide cash instead of shares under the terms of the scheme.
    - The employee can choose to receive cash instead of shares under the terms of the scheme.
    - The terms of the scheme include flexibility to vary the scheme (including to cancel awards for market consideration in cash) in specific situations (eg when the company is sold or an employee retires).
    - The scheme is a phantom (or shadow) share (or option) scheme.[3]

2 It does not consider the treatment of cash-settled ESS benefits provided to an independent contractor, for example, a non-executive director.

3 A phantom share scheme can operate in a variety of ways, but the key point is that the employee does not become a shareholder in the company. The benefits of a phantom share scheme are paid out in cash.

22. When considering an employer's withholding obligations, it is necessary to understand the nature of the income received. In the case of a cash-settled ESS benefit, it is important to be sure that the cash amount received is in fact a benefit received under an ESS (as defined in the legislation) and not, for example, a cash bonus.

23. A benefit received under an ESS is income under s CE 1(1)(d), while a cash bonus is income under s CE 1(1)(a).

> **CE 1 Amounts derived in connection with employment**
>
> *Income*
>
> (1) The following amounts derived by a person in connection with their employment or service are income of the person:
>
> (a) salary or wages or an allowance, bonus, extra pay, or gratuity;
>
> …
>
> (d) a benefit received under an employee share scheme:
>
> …

24. The requirements for an amount[4] to be income under s CE 1(1)(d) are that the amount:

- must be derived in connection with the employment or service of the person;
- must be received under an "employee share scheme" as defined in s CE 7; and
- must give rise to a "benefit" under s CE 2.

25. The first requirement applies to all amounts that are income under s CE 1(1) (eg salary or wages, a bonus, extra pay or gratuity). It is not directly relevant to the question of whether a cash benefit is an ESS benefit or something else, for example a bonus. This statement assumes that the cash payment in question is derived in connection with an employee's employment.

26. The second and third requirements determine whether the amount is a benefit received under an ESS and these are set out below.

Is the amount received under an "employee share scheme"?

27. "Employee share scheme" is defined in s CE 7.

> **CE 7 Meaning of employee share scheme**
>
> **Employee share scheme** means—
>
> (a) an arrangement with a purpose or effect of issuing or transferring shares in a company (**company A**) to a person—
>
> (i) who will be, is, or has been an employee of company A or of another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:
>
> (ii) who will be, is, or has been a shareholder-employee in relation to company A or in relation to another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:
>
> (iii) who is an associate of a person described in subparagraph (i) or (ii) (**person A**), if the arrangement is connected to person A's employment or service; but
>
> (b) does not include an arrangement that—
>
> (i) is an exempt ESS:
>
> (ii) requires market value consideration to be paid by a person described in paragraph (a) for the transfer of shares in the company on the share scheme taxing date:
>
> (iii) requires a person described in paragraph (a) to put shares, acquired by them for market value consideration, at risk, if the arrangement provides no protection against a fall in the value of the shares and none of the consideration for acquiring the shares is provided to the person under an agreement that it is used for acquiring the shares.

28. Broadly, an ESS is an arrangement:

- with a purpose or effect of issuing or transferring shares in a company to a person who will be, is, or has been an employee (or shareholder-employee) of that company or another company in the same group; and
- that is connected to the employee's (or shareholder-employee's) employment or service.

4 An amount includes an amount in money's worth (s YA 1).

29. An employee and shareholder-employee are persons described in s CE 7(a)(i) and (ii). An ESS also includes providing shares to an associate of an employee or a shareholder-employee (being a person described in s CE 7(a)(iii)) if the arrangement is in connection with the employee or shareholder-employee's employment or service.
30. Accordingly, the person who receives shares under an ESS could be the employee, shareholder-employee or an associate (and such a person is an "employee share scheme beneficiary" under s CE 7C). Regardless of who receives the shares, it is the employee or shareholder-employee that derives any employment income from the ESS as set out in s CE 1(1)(d) and s CE 2 (see [46] and [47]). This is because s CE 2(1) provides that a person who is described in s CE 7(a)(i) or (ii) (being the employee or the shareholder-employee) receives the benefit calculated under s CE 2, and therefore the income under s CE 1(1)(d).
31. When a person receives cash instead of shares under an incentive scheme, the key issue is whether the scheme is "an arrangement with a purpose or effect of issuing or transferring shares" in a company to a person (s CE 7(a)). The relevant questions are:
    - Is there an arrangement?
    - Does the arrangement have a purpose or effect of issuing or transferring shares in a company to a person?
32. Whether the amount received is cash rather than shares does not affect the other requirements of the definition of "employee share scheme". Therefore, this statement assumes the other requirements of the definition of "employee share scheme" are met. That is:
    - the person will be, is or has been an employee (or shareholder-employee) of the company or of another company in the same group (or is an associate of the employee or shareholder-employee);
    - the arrangement is connected to the employee's (or shareholder-employee's) employment or service; and
    - none of the exclusions in s CE 7(b) apply.
33. For simplicity, where this interpretation statement refers to an employee, it includes a shareholder-employee or an associate of the employee or shareholder-employee in question (as relevant).

Is there an arrangement?

34. An "arrangement" is defined in s YA 1:

> **Arrangement** means an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect.

35. The use of the term "arrangement" in the definition of "employee share scheme" covers all aspects of a scheme, for example, direct transfers of shares, loans to buy shares, bonuses, put and call options, and transfers to trusts.[5]
36. An ESS will ordinarily be an "arrangement" and will typically consist of more than one document, for example, an offer letter, an acceptance form and the share scheme rules.

Does the arrangement have a purpose or effect of issuing or transferring shares in a company to a person?

37. When **cash is received** instead of shares under an incentive scheme, the key issue is whether the arrangement has **a purpose or effect of issuing or transferring shares** in a company to a person.
38. The courts have considered the words "purpose or effect" in a tax avoidance context.[6] The following are the main points from those cases that are relevant to an ESS:
    - The courts tend to treat the phrase "purpose or effect" as a composite term. That is, although presented as alternatives, the words do not have any real difference in meaning because the purpose is deduced from the effect.
    - The purpose or effect of an arrangement is determined objectively. The subjective motives, intentions or purposes of the parties are not relevant.
    - The objective purpose of the arrangement is determined by considering the intended effect of the arrangement (or the effect that the arrangement sought to achieve).
    - The effect of an arrangement must be ascertained from the terms of the arrangement.

5 **Employee share schemes** *Tax Information Bulletin* Vol 30, No 5 (June 2018): 53

6 For more on the meaning of "purpose or effect", see **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** *Tax Information Bulletin* Vol 35, No 2 (March 2023).

- The analysis does not depend on hindsight. The relevant time to consider the purpose or effect of an arrangement is the time the arrangement was entered into. The arrangement is not judged on the basis of what actually happened afterwards.

39. Following this approach, the starting point is to consider the terms of the arrangement in order to see what the effect of the arrangement is (ie what it does). This is considered at the time the arrangement is entered into and does not depend on hindsight. The effect of the arrangement will be its objective purpose.
40. In an **ordinary share scheme** where an employee receives shares on vesting or when options are exercised, the effect of the terms of the arrangement is that shares will be transferred (or issued) to the employee. The purpose is the intended effect (or the effect the arrangement seeks to achieve). In this case, the arrangement is an ESS (assuming the conditions of s CE 7(a)(i) to (iii) are met and none of the exclusions in s CE 7(b) apply).
41. In the situation where the terms of a scheme mimic those of an ordinary share or option scheme but **the incentive is always paid in cash**, the arrangement clearly does not have a purpose or effect of transferring or issuing shares. This type of arrangement is commonly referred to as a phantom share scheme and is not an ESS for tax purposes. See Example | Tauira 1.
42. In the situation where the terms of the arrangement provide for the award to be settled **partly in shares and partly in cash**, **an** intended effect of the arrangement is to transfer shares to the employee. A purpose of the arrangement is therefore also to transfer shares to the employee. The use of the word “a” before “purpose or effect” in s CE 7(a) shows that transferring shares does not have to be the sole or even principal purpose or effect of the arrangement. See Example | Tauira 2.
43. In the situation where the employer grants share or option rights to an employee but reserves the right to provide **cash instead of shares** on vesting or exercise of the options under the terms of the arrangement, the intended effect of the arrangement is to transfer either cash or shares. This means there is a purpose of transferring shares. See Example | Tauira 3.
44. Another situation that commonly arises is where the terms of the arrangement state that an employee will receive shares on vesting (or when an option is exercised) but the agreement also allows for an employer to **cancel the rights and provide cash** based on the market value of the shares in certain circumstances (eg on the sale of the company or retirement of an employee). Here, the effect of the terms of the arrangement is that shares will be transferred to the employee in the normal course of events. Although the terms of the arrangement also contemplate that shares may not be transferred to an employee in certain circumstances, this possibility does not prevent the arrangement from having a purpose or effect of transferring shares to an employee. See Example | Tauira 6 and Example | Tauira 7.
45. Generally, if the terms of the arrangement allow for the employer to issue or transfer company shares to an employee, the arrangement will have a purpose or effect of issuing or transferring shares even in circumstances where shares are not in fact issued or transferred.

Does the cash payment give rise to a “benefit” under s CE 2?

46. The third requirement for an amount to be income under s CE 1(1)(d) (a benefit received under an ESS) is that the amount gives rise to a “benefit” under s CE 2.
47. An employee receives a benefit in relation to shares or related rights (eg options) under an ESS equal to the amount calculated using the formula in s CE 2(1) and (2).

CE 2 Benefits under employee share schemes

Benefit

(1) A person who is an employee share scheme beneficiary described in section CE 7(a)(i) or ii) receives a benefit for the purposes of section CE 1(1)(d) in relation to shares or related rights under the employee share scheme equal to the positive amount calculated on the share scheme taxing date using the formula—

share value − consideration paid + consideration received − previous income.

Definition of items in formula

(2) In the formula in subsection (1),—

(a) **share value** is the market value of the shares or related rights owned by an employee share scheme beneficiary on the share scheme taxing date, if the share scheme taxing date is not triggered by a transfer or cancellation of the shares or related rights:

(b) **consideration paid** is the amount of consideration paid or payable by an employee share scheme beneficiary in relation to the transfer of the shares or related rights under the employee share scheme:

(c) **consideration received** is the amount of consideration paid or payable to an employee share scheme beneficiary in relation to a transfer or cancellation of the shares or related rights under the employee share scheme, not including relevant shares or related rights under a replacement employee share scheme:

(d) **previous income** is the total amount of income under section CE 1(1)(d) that the employee share scheme beneficiary has in relation to the shares or related rights before the date that is 6 months after the date of Royal assent for the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018.

…

48. Importantly, the amount of the benefit is calculated on the "share scheme taxing date" and the items in the formula that will be relevant depend on what triggers the share scheme taxing date (s CE 2(1) and (2)). "Share scheme taxing date" is defined in s CE 7B:

CE 7B Meaning of share scheme taxing date

Meaning

(1) **Share scheme taxing date** means, in relation to shares or related rights under an employee share scheme, the earlier of the following dates:

(a) the first date when the shares are held by or for the benefit of an employee share scheme beneficiary (**beneficial ownership**) and after which, under the provisions of the scheme,—

(i) there is no material risk that beneficial ownership may change or that a right or requirement in relation to the transfer or cancellation of the shares may operate; and

(ii) there is no benefit accruing to the employee share scheme beneficiary in relation to a fall in value of the shares; and

(iii) there is no material risk that there will be a change in the terms of the shares affecting the value of the shares:

(b) the date when the shares or related rights of an employee share scheme beneficiary are cancelled or are transferred to a person who is not associated with a beneficiary described in section CE 7(a)(i) or (ii).

Exclusions

(2) For the purposes of applying subsection (1), the following requirements and rights are ignored:

(a) a right or requirement in relation to transfer by the employee share scheme beneficiary for market value consideration at the time of the transfer:

(b) a right or requirement that is not contemplated by the employee share scheme's provisions:

(c) a right or requirement that, at the time it came into existence, had no material risk of operating or no material commercial significance:

(d) a right or requirement in relation to the transfer of shares, if the right or requirement is 1 that also applies to shares not under the employee share scheme.

49. The share scheme taxing date is the earlier of the dates specified in paras (a) and (b) of s CE 7B(1). Paragraph (a) is the date when shares are held by or for the benefit of the ESS beneficiary and there are no provisions in the scheme that would defer that date under subparas (i) to (iii). Paragraph (b) is the date when the shares or related rights are cancelled or transferred to a person who is not associated with the employee (eg the employer).

50. The items in the benefit calculation formula set out in s CE 2(1) that are relevant depend on what triggers the share scheme taxing date. Generally:
    - When the share scheme taxing date is triggered by shares being held by or for the benefit of the employee (share ownership) under s CE 7B(1)(a), the relevant item in the benefit calculation formula is "share value" as defined in s CE 2(2)(a) (being the market value of the shares on the share scheme taxing date) less any "consideration paid" as defined in s CE 2(2)(b) (being the amount of the consideration paid by the employee for the shares). See Example | Tauira 5.
    - When the share scheme taxing date is triggered by the cancellation or transfer of the shares or related rights under s CE 7B(1)(b), the relevant item in the benefit calculation formula is "consideration received" as defined in s CE 2(2)(c) (being the cash paid or payable to the employee in relation to that transfer or cancellation) less any "consideration paid" as defined in s CE 2(2)(b) (being the amount of consideration paid by the employee in relation to the shares or rights). See Example | Tauira 3, Example | Tauira 4, Example | Tauira 6 and Example | Tauira 7.
51. Accordingly, for the purposes of this statement, what triggers the share scheme taxing date determines whether a "benefit" under an ESS is received in shares (s CE 7B(1)(a) and s CE 2(2)(a)) or cash (s CE 7B(1)(b) and s CE 2(2)(c)).
52. Not all cash paid to an employee under an ESS will give rise to an ESS benefit. For example, in the situation where the terms of an ESS state that an incentive will be paid partly in cash and partly in shares, then the part of the incentive that is paid in cash will not be paid in relation to a transfer or cancellation of shares or related rights under an ESS. In other words, the payment would not trigger the share scheme taxing date under s CE 7B(1) and therefore no benefit under s CE 2 would arise. The cash incentive would instead be a bonus or extra pay and income to the employee under s CE 1(1)(a). The part of the incentive scheme that is settled in shares would trigger the share scheme taxing date under s CE 7B(1)(a) and give rise to a benefit under an ESS and income to the employee under s CE 1(1)(d). See Example | Tauira 2.
53. Another example is where an employer pays a bonus to cover the employee's tax liability in relation to a share-settled ESS benefit. Although the bonus might be part of the ESS arrangement, it is not an amount paid to the employee in relation to a transfer or cancellation of the shares or related rights under the ESS. In other words, the bonus would not trigger the share scheme taxing date under s CE 7B(1) and therefore no benefit under s CE 2 would arise. The cash paid in that situation would instead be a bonus or extra pay and income to the employee under s CE 1(1)(a).
54. It is worth noting that the deduction for the employer under s DV 27(5) also expressly identifies that other employment income may arise under an ESS. Section DV 27(5) is intended to preserve a deduction for the cost of paying a bonus where the payment of the bonus is part of the terms of the ESS.[7] Another example is when the employer pays a bonus to facilitate the employee repaying a loan on vesting (where the loan was used to purchase the shares). Section DV 27(5) states:

> **DV 27 Employee share schemes**
>
> *When this section applies*
>
> (1) This section applies when a person is party to an employee share scheme.
>
> *No deduction except as provided by this section*
>
> (2) Except as provided by this section, the person is denied a deduction for an amount of expenditure or loss for an income year incurred in relation to the employee share scheme.
>
> …
>
> *Employment income*
>
> (5) The person is allowed a deduction for an amount of expenditure or loss incurred on employment income other than under section CE 1(1)(d) (Amounts derived in connection with employment).
>
> …

7 **Employee share schemes** (June 2018) at 64

Summary

55. A "cash-settled ESS benefit" is not defined in the legislation. It is a term used in this statement to describe a cash payment that is made to an employee where:
    - the employee receives the amount under an "employee share scheme"; and
    - the amount gives rise to a "benefit" under an ESS.
56. Broadly, an amount will be received under an "employee share scheme" if the scheme is an arrangement with a purpose or effect of issuing or transferring shares in a company to an employee. This requirement is assessed when the scheme is entered into. If the terms of the scheme allow for shares to be issued or transferred to an employee, then there will generally be a purpose or effect of issuing or transferring shares even in circumstances where the shares are not ultimately transferred to the employee in question. The arrangement must also be connected to the employee's employment or service.
57. A cash amount will give rise to a benefit under an ESS if the share scheme taxing date is triggered by a transfer or cancellation of shares or related rights under s CE 7B(1)(b) and the cash amount is paid in relation to that transfer or cancellation.

Is an employer required to withhold tax from a cash-settled employee share scheme benefit?

58. An employer's withholding obligations are set out in s RA 5:[8]

> **RA 5 Tax obligations for employment-related taxes**
>
> *Withholding and payment obligations*
>
> (1) A person who makes a payment or provides a benefit of 1 of the following kinds must either withhold and pay, or pay, the amount of tax for the payment or benefit to the Commissioner under subpart RD (Employment-related taxes) by the due dates:
>
> (a) a PAYE income payment:
>
> (b) a fringe benefit:
>
> (c) an employer's superannuation cash contribution.
>
> *Timing for PAYE income payments*
>
> (2) An amount of tax withheld from a PAYE income payment must be withheld at the time the person makes the payment.

59. An employer is required to withhold and pay (or pay) tax for a PAYE income payment, a fringe benefit and an employer's superannuation cash contribution. An ESS benefit is not a superannuation cash contribution or a fringe benefit.[9] Therefore the question is whether an ESS benefit (and in particular a cash-settled ESS benefit) is a "PAYE income payment". If it is, then an employer will be required to withhold tax from the payment.
60. "PAYE income payment" is defined in s RD 3:

> **RD 3 PAYE income payments**
>
> *Meaning generally*
>
> (1) The PAYE rules apply to a **PAYE income payment** which—
>
> (a) means—
>
> (i) a payment of salary or wages, see section RD 5; or
> (ii) extra pay, see section RD 7; or
> (iii) a schedular payment, see section RD 8:
>
> (b) does not include—
>
> (i) an amount attributed under section GB 29 (Attribution rule: calculation):
> (ii) an amount paid to a shareholder-employee in the circumstances set out in section RD 3B or RD 3C:
> (iii) an amount paid or benefit provided, by a person (the **claimant**), who receives a personal service rehabilitation payment from which an amount of tax has been withheld at a rate specified in section RD 10B.
>
> …

8 See also s BE 1(1) (Withholding liabilities – PAYE income payments) and s RD 1 (Employment-related taxes – Introductory provision).

9 An ESS benefit is excluded from being a fringe benefit because it is included in the assessable income of an employee under s CE 1(1)(d). (See s CX 4.)

61. A PAYE income payment means a payment of salary or wages, an extra pay or a schedular payment.[10]
62. "Salary or wages" (s RD 5) and "extra pay" (s RD 7) are payments made to a person in connection with their employment. Salary or wages are generally regular amounts, and an extra pay is generally a one-off amount. They are defined separately because the amount of tax withheld from an extra pay is calculated differently to PAYE on salary or wages.
63. Because a cash-settled ESS benefit is generally a one-off payment, the starting point is whether it is an extra pay. If an amount is an "extra pay", then it is excluded from being salary or wages (s RD 5).[11]

Is a cash-settled employee share scheme benefit an extra pay?

64. An extra pay is relevantly defined in s RD 7.[12]

> **RD 7 Extra pay**
>
> *Meaning*
>
> (1) An **extra pay**—
>
> (a) means a payment that—
>
> (i) is made to a person in connection with their employment; and
>
> (ii) is not a payment regularly included in salary or wages payable to the person for a pay period; and
>
> (iii) is not overtime pay; and
>
> (iv) is made in 1 lump sum or in 2 or more instalments; and
>
> (b) includes a payment of the kind described in paragraph (a) made—
>
> (i) as a bonus, gratuity, or share of profits; or
>
> (ii) as a redundancy payment; or
>
> (iii) when the person retires from employment; or
>
> (iv) as a result of a retrospective increase in salary or wages, but only to the extent to which it accrues from the start of the increase until the start of the first pay period in which the increase is included in salary or wages; and
>
> (bb) includes a benefit under section CE 1(1)(d) (Amounts derived in connection with employment) in relation to which the employer has made an election under section RD 7B to withhold an amount of tax; and
>
> …
>
> (d) does not include a payment of exempt income.
>
> …

65. Paragraph (a) of s RD 7 sets out the general definition of "extra pay". It defines what an extra pay **means** for tax purposes. A cash-settled ESS benefit will generally fall within the definition of extra pay for the following reasons:
    - It is a payment of cash.
    - The payment is made to an employee in connection with their employment. It is a requirement of the definition of "employee share scheme" that the arrangement is connected to the person's employment or service so this requirement is met. In other words, if a cash payment is a benefit under an ESS (ie the ESS benefit has come into fruition under s CE 7B(1)(b)) then the payment will be connected with the employee's employment.
    - The payment is not a payment regularly included in salary or wages payable to the person for a pay period.
    - The payment is not overtime pay.
    - The payment is made in one lump sum or two or more instalments (ie a payment is still an "extra pay" even if it is not made in one lump sum).
66. Therefore, the starting point is that a cash-settled ESS benefit provided to an employee will generally be an "extra pay" under the general definition of extra pay in s RD 7(1)(a).

10 This interpretation statement assumes that none of the exclusions in s RD 3(1)(b) apply.

11 Whether a cash-settled ESS benefit can in some circumstances be a schedular payment is outside the scope of this interpretation statement. This statement only considers cash-settled ESS benefits where the recipient of the benefit is an employee (under a contract of service).

12 This statement assumes that a cash-settled ESS benefit is not a payment of exempt income under para (d).

67. The amount of the payment is the amount of the benefit in cash under the formula in s CE 2(1). This will generally be the amount paid to the employee for the transfer or cancellation of shares or related rights (which includes a payment for the cancellation of a share option). Sometimes the employee might have paid an amount to acquire shares at the outset. In this situation, the Commissioner considers that the payment will be the net amount of the benefit in cash.

68. For completeness, a share-settled ESS benefit is not an extra pay under s RD 7(1)(a). This is because a "payment" in the context of employment income and the PAYE rules is generally considered to be a sum of money. A share-settled benefit is a non-cash benefit and as such is not a "payment".

69. Paragraph (b) of s RD 7 gives examples of the types of payments that fall within the general definition of "extra pay". The words "of the kind" indicate that the list of payments is intended to be illustrative or explanatory rather than exhaustive.[13] The word "includes" here is a further indication that the list is not intended to be exhaustive.[14]

70. Given the payments listed in para (b) are intended to be illustrative rather than exhaustive, the fact that a cash-settled ESS benefit is not specified in para (b) does not prevent it from being an extra pay under para (a).

71. Paragraph (bb) of s RD 7 relates specifically to ESS benefits. It has been suggested that this reference to ESS benefits means that such benefits should not constitute an extra pay as defined unless para (bb) is satisfied. It is helpful to consider how para (bb) applies to share-settled ESS benefits before considering whether it applies to cash-settled ESS benefits.

Paragraph (bb) – share-settled benefits

72. For ease of reference, para (bb) is restated here:

> **RD 7 Extra pay**
>
> *Meaning*
>
> (1) An **extra pay**—
>
> …
>
> (bb) includes a benefit under section CE 1(1)(d) (Amounts derived in connection with employment) in relation to which the employer has made an election under section RD 7B to withhold an amount of tax;

73. The requirements for a benefit to be an extra pay under para (bb) are that:

- it must be a benefit under s CE 1(1)(d); and
- the employer must have made an election under s RD 7B to withhold an amount of tax in relation to the benefit.

74. A share-settled ESS benefit is a benefit under s CE 1(1)(d) (ie a benefit received under an ESS).

75. Section RD 7B sets out when an employer has made an election to withhold tax from an ESS benefit.

> **RD 7B Treatment of employee share schemes**
>
> *When this section applies*
>
> (1) This section applies for employees or a former employee in relation to benefits under an employee share scheme, if—
>
> (a) an employer has irrevocably chosen to withhold and pay tax for a benefit for an employee under the scheme in accordance with subsection (3); or
>
> (b) an employer chooses to withhold and pay tax for a benefit for an employee under the scheme in accordance with subsection (4).
>
> *Irrevocable obligation*
>
> (2) An employer who has made an irrevocable election described in subsections (1)(a) and (3) must comply with subsection (4)(a) to (c) for—
>
> (a) the relevant benefit and employee under the scheme:
>
> (b) benefits offered or provided to the employee in replacement of the relevant benefit.
>
> *Irrevocable obligation: form*
>
> (3) For the purposes of subsection (1)(a), an employer has irrevocably chosen to withhold and pay tax for a benefit for an employee, if it is a term of the offer of the benefit, or of the scheme under which the benefit is provided, that the employer must withhold and pay tax under this section.

13 *Northland Environmental Protection Society Inc v Chief Executive of the Ministry for Primary Industries* [2019] 1 NZLR 257 at [48] considers the words "such as" in a similar context.

14 R Carter, *Burrows and Carter Statute Law in New Zealand* (6th ed, LexisNexis, Wellington, 2021) at 568

Withholding and paying

(4) For the purposes of subsection (1)(b), an employer chooses to withhold and pay tax for some benefits for some employees by—

(a) calculating the amounts of tax that must be withheld for the relevant benefits and employees, and paying the amounts to the Commissioner as described in section RD 4(1); and

(b) including the amounts in the employer's employment income information under subpart 3C of the Tax Administration Act 1994, treating the relevant ESS deferral date as the relevant payday; and

(c) making the disclosure referred to in paragraph (b) within the time required under section RD 6(3)(a).

76. Section RD 7B allows an employer to choose to withhold tax on an ESS benefit provided to an employee. An employer can make the election when the benefit is provided by calculating the amount of tax, paying the tax to Inland Revenue and including the amount of the tax in its EI return in the timeframe required.

77. Alternatively, an employer can make an irrevocable election to withhold and pay tax on an ESS benefit at the time the benefit is offered. It makes this election by including in the terms of the offer or the scheme that the employer must withhold and pay tax under s RD 7B. The employer must also comply with the withholding and payment requirements of subs (4) of s RD 7B.[15]

78. If an employer has made an election to withhold tax from a share-settled ESS benefit under s RD 7B, then the benefit is treated as an extra pay under s RD 7(1)(bb). As such, it is a PAYE income payment (s RD 3) and subject to the PAYE rules (s RD 2(2)).

RD 2 PAYE rules and their application

Meaning

(1) The **PAYE rules** means—

(a) section BC 1 (Non-filing and filing taxpayers); and

(b) sections LA 6, LB 1, and LD 4 (which relate to tax credits); and

(c) sections RD 3 to RD 24; and

(d) sections RP 2 to RP 16 (which relate to PAYE intermediaries); and

(e) subparts 3C and 3D, sections 22AA, 124H to 124K, 124O to 124Q, 133, Part 9, sections 167 to 169, and schedules 4 and 5 of the Tax Administration Act 1994.

Application

(2) The PAYE rules apply to a person who makes or is required to make a PAYE income payment and, in certain circumstances, to the person to whom the PAYE income payment is made.

…

79. Under the PAYE rules, an employer is required to pay the tax withheld to Inland Revenue and report the value of the benefit and the amount of tax withheld in its EI return on the relevant date.

80. If the employer has not made an election to withhold tax from a share-settled ESS benefit, then the benefit is not an extra pay or a PAYE income payment. However, the benefit is still income to the employee under s CE 1(1)(d). Under the PAYE rules, the employer is required to report the value of the benefit to Inland Revenue in its EI return (unless the person is a former employee). A former employee must report the value of the benefit in their tax return themselves. The employee (including if they are a former employee) pays tax on the benefit through the end-of-year tax return process (and through provisional tax if applicable).[16]

15 The irrevocable election was introduced to enable employers to meet the requirements to adopt equity-settled accounting treatment for the withheld tax under International Financial Reporting Standards. See **Employee share schemes – withholding obligations** *Tax Information Bulletin* Vol 31, No 8 (September 2019): 85.

16 See **QB 23/05: Provisional tax – impact on salary or wage earners who receive a one-off amount of income without tax deducted** *Tax Information Bulletin* Vol 35, No 5 (June 2023)

Paragraph (bb) – cash-settled benefits

81. On first impression, the election to withhold tax on an ESS benefit could also apply to cash-settled benefits. However, as a cash-settled ESS benefit is already an extra pay under s RD 7(1)(a) (from which an employer is required to withhold tax), this raises the question of how ss RD 7(1)(a), RD 7(1)(bb) and RD 7B interact.

82. Section 10(1) of the Legislation Act 2019 states that "the meaning of legislation must be ascertained from its text and in the light of its purpose and its context".[17] It is therefore useful to consider:

- the structure of the definition of extra pay;
- the history of the introduction of ss RD 7(1)(bb) and RD 7B;
- the broader statutory context; and
- the interaction of ss RD 7(1)(a), RD 7(1)(b) and RD 7B.

The structure of the definition of "extra pay"

83. The structure of the definition of "extra pay" uses the words "means", "includes" and "does not include". In *Northland Environmental Protection Society*, the Supreme Court described this structure as straightforward and conventional with the "includes" part of the structure extending the general definition in certain respects.

> [39] Turning to the wording of the definition of finished or manufactured indigenous timber product, the first point is that this definition has a straight forward and conventional structure. Para (a) contains the general definition. Para (b) extends the definition in certain respects, while para (c) excludes certain categories of items that would otherwise come within paras (a) or (b).

84. Likewise in *Begg v CIR* (2009) 24 NZTC 23,473, the Court of Appeal held (at [18] to [30]) that a definition containing both the words "means" and "includes" enlarges or extends the ordinary meaning of the defined term. This meant that the thing "included" did not need to come within the "means" part of the definition.

85. In *Progressive Meats Ltd v Ministry of Health* [2008] NZCA 162 the Court of Appeal agreed with the District Court judge's approach that the use of the "means" and "includes" technique in that case gave rise to an extended definition of "workplace".

86. The case law shows that the usual approach to a "means" and "includes" definition is to interpret the "includes" part of the definition as extending the "means" part to cover things that would not ordinarily come within it. As s RD 7(1)(b) demonstrates, "includes" is also used to give examples of things that come within the "means" definition without the intention that the examples are exhaustive. While these are the normal uses of "includes" in a "means" and "includes" definition, "includes" may have other effects depending on the context.[18]

87. Section RD 7(1)(bb) extends the definition of extra pay to include ESS benefits **in relation to which** an employer has made an election to withhold tax under s RD 7B. The words "in relation to" express a way in which two things are connected. The *Oxford English Dictionary* defines "relation" as follows:[19]

> **Relation, n. 2. a.** An attribute denoting or concept expressing a connection, correspondence, or contrast between different things; a particular way in which one thing or idea is connected or associated with another or others; a link, a correlation; the fact of being so connected, associated, etc.; connection, association. Frequently with *to*, *between*, or *with*.

88. In the Commissioner's view, the use of the words "in relation to" in para (bb) does not limit the general definition of extra pay in para (a). In the context of the history of the legislation, s RD 7(1)(bb) simply extends the meaning of extra pay to include benefits where the employer has elected to withhold tax. It does not prevent a cash-settled ESS benefit from being an extra pay under s RD 7(1)(a).

89. The question is whether an employer has made an election under s RD 7B. On first impression, the election can apply to both cash- and share-settled benefits. However, an indication that the election is intended to apply only to share-settled benefits can be found in s RD 7B(4)(c), which refers to s RD 6(3)(a). Section RD 6(3)(a) applies when an employee receives the benefit otherwise than in cash.

17 For more on s 10(1) of the Legislation Act 2019, see 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.

18 Carter at 570

19 *Oxford English Dictionary* (online edition, Oxford University Press 2023, accessed 22 December 2023)

> **RD 6 Certain benefits and payments**
>
> *When this section applies*
>
> (1) This section applies when an employee receives—
>
> …
>
> (d) a benefit under section CE 1(1)(d) (Amounts derived in connection with employment) in relation to which the employer has made an election under section RD 7B; or
>
> …
>
> *When non-cash benefit treated as paid*
>
> (3) If the employee receives the benefit otherwise than in cash, the value is treated as paid—
>
> (a) for a benefit referred to in subsection (1)(d), on the ESS deferral date on which the employee is treated as deriving the benefit under section CE 2(8) (Benefits under employee share schemes); or
>
> …

90. Section RD 7B proceeds on the basis that there is a **choice** to withhold. Likewise s RD 7(1)(bb) refers to an election. In the Commissioner's view, an employer cannot choose or elect to withhold tax in relation to a cash-settled ESS benefit when withholding is already required (because a cash-settled benefit is an extra pay under s RD 7(1)(a)). The election can only apply to a share-settled benefit.
91. It could be argued that an employer always chooses to withhold tax for a cash-settled ESS benefit and therefore a cash-settled benefit will be an extra pay under both paras (a) and (bb) of s RD 7(1). This argument proceeds on the basis that a cash-settled ESS benefit is an extra pay under s RD 7(1)(a) and so an employer will necessarily meet all the requirements of an election under s RD 7B(4). In the Commissioner's view, this argument is circular in nature and the better view is that an employer has not made (and cannot make) an election under s RD 7B for a cash-settled ESS benefit.

The history of the introduction of ss RD 7(1)(bb) and RD 7B

92. The background and legislative history of the introduction of ss RD 7(1)(bb) and RD 7B show the following:
    - The genesis for the changes was that some employers approached Inland Revenue about using the PAYE system to return tax on their employees' behalf.
    - The officials' issues paper **Simplifying the collection of tax on employee share schemes** (Inland Revenue, April 2015) was only concerned with non-monetary ESS benefits.
    - The overarching purpose of the changes was to **simplify tax compliance** for employees. If an employer withholds tax, then the employee should not have additional tax to pay at the end of the year or become a provisional taxpayer as a result of receiving an ESS benefit.
    - Other reasons for the changes were to reduce the risk of non-compliance and minimise Inland Revenue's administration costs. (It is more efficient for tax to be withheld at source.)
    - Withholding was made elective rather than compulsory because Parliament accepted stakeholders' concerns that compulsory withholding may impose additional compliance costs on employers, meaning that taxing ESS benefits at source was not always appropriate or efficient.[20] These concerns apply to share-settled benefits only.
93. The legislation achieves its main purpose of simplifying compliance for employees (if the employer elects to withhold tax) in relation to share-settled benefits.
94. However, a cash-settled ESS benefit was already (and still is) an extra pay under the general definition of extra pay and subject to tax at source. New legislation was not necessary to allow an employer to withhold tax from a cash-settled benefit. Applying the legislation so that a cash-settled ESS benefit is **only** an extra pay **if** an election is made would be inconsistent with the main purpose of simplifying compliance for employees. It would result in more employees paying tax on the benefit through the end-of-year tax process and potentially becoming provisional taxpayers.
95. The purposes of reducing the risk of non-compliance and minimising Inland Revenue's administrative costs are also achieved for share-settled benefits (where an election is made) but not for cash-settled benefits.
96. Overall, the history of the introduction of the election to withhold PAYE on ESS benefits shows that it was only intended to apply to non-cash benefits.

20 **Taxation (Transformation: First Phase Simplification and Other Measures) Bill (Regulatory Impact Statements, Policy and Strategy,** Inland Revenue, June 2015) at [61]

The broader statutory context

97. Employment income is generally taxed at source, under either the PAYE or FBT rules. It clearly fits within the scheme of the Income Tax Act 2007 (the Act) to withhold tax from share scheme benefits that were not previously subject to tax at source (ie share-settled benefits). However, it would be inconsistent with the scheme of the Act for a cash-settled ESS benefit that was previously subject to tax at source to now only be subject to tax at source at the election of the employer.

98. It is also relevant to the integrity of the tax system and perceptions of fairness if some cash amounts received by employees are subject to tax at source and others are only subject to tax at source at the election of the employer.

The interaction of ss RD 7(1)(a), RD 7(1)(b) and RD 7B

99. A cash-settled ESS benefit is an extra pay under the general definition of extra pay (s RD 7(1)(a)). On first impression, it could also be an extra pay under s RD 7(1)(bb) if an employer has elected to withhold tax.

100. In *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, the Supreme Court stated at [24]:

> Where, as here, the meaning is not clear on the face of the legislation, the court will regard context and purpose as essential guides to meaning.

101. In relation to inconsistent provisions, Carter states at 607–608:

> Normally it will be found, on reading the Act as a whole, taking into account scheme and purpose, that the two provisions can in fact be read consistently, albeit by "reading down" one of them. Often it will be discovered on such a contextual reading that the reader's own first impressions of one section have to be modified.
>
> …
>
> Sometimes the reconciliation requires a strained interpretation to be given to one section; the law has always recognised that the avoidance of internal inconsistency can justify some liberality with words. In some such cases it is necessary to decide, in the light of the scheme and purpose of the legislation, which of the two provisions is the dominant one, requiring the other to be read down. … In determining which of two sections is to have primacy, regard may be had to their purpose, their history, and even their positioning in the Act.

102. Looking at the situation as a whole and considering the purpose of the legislation, the history and the statutory context, the Commissioner considers that s RD 7(1)(bb) extends the definition of extra pay to include share-settled ESS benefits where the employer has elected to withhold tax under s RD 7B. It does not apply to cash-settled ESS benefits that are already an extra pay under s RD 7(1)(a).

Summary

103. The definition of "extra pay" applies to ESS benefits as follows:

- A cash-settled ESS benefit is an extra pay under the general definition of extra pay in s RD 7(1)(a).
- Section RD 7(1)(bb) extends the general definition of extra pay to include a share-settled benefit where the employer has elected to withhold tax.
- An employer cannot (and does not) make an election to withhold tax for a cash-settled ESS benefit.

104. This view is supported by the overarching purpose of the election, which is to simplify tax for employees by allowing an employer to withhold tax at source. It would not be consistent with that purpose if an employer was able to choose not to withhold tax from a benefit where withholding was already required under the Act. This conclusion is also consistent with the scheme of the Act, which is to tax employment income at source.

ACC earners' levy

105. An employer's obligations regarding collecting ACC earners' levy are set out in the Accident Compensation Act 2001 (ACC Act). An issue related to whether an employer is required to withhold tax from a cash-settled benefit under the PAYE rules is whether the earners' levy also applies to cash-settled ESS benefits.
106. An employer collects the earners' levy by making a deduction from an employee's "earnings" (s 221 of the ACC Act). "Earnings" includes "earnings as an employee" (s 6 of the ACC Act). "Earnings as an employee" means all PAYE income payments (as defined in s RD 3(1)) of the person for the tax year (s 9 of the ACC Act).
107. Section 11 of the ACC Act excludes from "earnings as an employee" any benefit arising from an ESS under s CE 2 when the employer makes an election under s RD 7B to withhold and pay tax in relation to the benefit.[21]

> **11 Earnings as an employee: what it does not include**
>
> (1) Earnings as an employee, in relation to any person and any tax year, does not include—
>
> …
>
> (cb) any benefit arising from a[n] employee share scheme under section CE 2 of the Income Tax Act 2007 when the employer makes an election under section RD 7B of that Act to withhold and pay tax in relation to the benefit; or
>
> …

108. Because a cash-settled ESS benefit is a PAYE income payment, as a starting point it is subject to ACC earners' levy. The question is whether the exclusion in s 11(1)(cb) of the ACC Act applies.
109. A cash-settled ESS benefit is a benefit arising from an ESS under s CE 2. The Commissioner considers that the choice to withhold tax in s RD 7B does not apply to a cash-settled ESS benefit. This is because a cash-settled ESS benefit is an extra pay under s RD 7(1)(a) and a PAYE income payment under s RD 3 from which an employer is required to withhold tax.
110. On the basis that an employer cannot and does not make an election under s RD 7B in relation to a cash-settled ESS benefit, the exclusion in s 11(1)(cb) of the ACC Act does not apply to a cash-settled ESS benefit. This means an employer is required to deduct ACC earners' levy from a cash-settled ESS benefit.
111. This outcome is consistent with the scheme of the Income Tax Act 2007, which is broadly that the ACC earners' levy applies to cash payments made to an employee (subject to the maximum thresholds).
112. For completeness, an employer is not required to deduct ACC earners' levy from a share-settled benefit where an employer has elected to withhold tax under s RD 7B.
113. In summary, an employer is required to deduct ACC earners' levy from a cash-settled ESS benefit. This outcome arises because a cash-settled ESS benefit is a PAYE income payment and is not excluded from the definition of "earnings as an employee" under the ACC Act because an employer does not make an election under s RD 7B to withhold tax in relation to a cash-settled ESS benefit.

Summary

114. A cash-settled ESS benefit is an extra pay and a PAYE income payment. As such, an employer is required to withhold an amount of tax from the payment under the PAYE rules at the appropriate extra pay rate. ACC earners' levy will also apply (subject to the usual maximum thresholds).

21 A similar exclusion applies for shareholder-employees in s 15 of the ACC Act.

Is an employer required to deduct student loan repayments from a cash-settled ESS benefit?

115. The Student Loan Scheme Act 2011 (SLS Act) sets out an employer's obligations for collecting student loan repayments under ss 36 and 37.

116. An employer collects student loan repayments by making a deduction from an employee's "salary or wages", which includes an "extra pay" under the SLS Act.[22] The definition of "salary or wages" in the SLS Act does not exclude an ESS benefit.

117. A cash-settled ESS benefit is an extra pay under s RD 7(1)(a). Accordingly, an employer is required to deduct student loan repayments from an ESS benefit.

118. For completeness, an employer is required to deduct student loan repayments in relation to a share-settled benefit where the employer has elected to withhold tax. In this situation the share-settled benefit is treated as an extra pay under s RD 7(1)(bb).

119. In summary, an employer is required to deduct student loan from a cash-settled ESS benefit. This outcome arises because wa cash-settled ESS benefit is an extra pay from which a student loan deduction is required under the SLS Act.

What are an employer's KiwiSaver obligations for a cash-settled employee share scheme benefit?

120. An employer's KiwiSaver obligations are determined under the KiwiSaver Act 2006 (KiwiSaver Act).

121. Broadly, if an employee is a KiwiSaver member and is not on a savings suspension (ie taking a break from making KiwiSaver contributions), then an employer is required to deduct KiwiSaver contributions at the relevant contribution rate from the employee's gross salary or wages.[23] An employer is also generally required to make a compulsory employer contribution based on an employee's gross salary or wages.[24]

122. "Salary or wages" is defined in s 4 of the KiwiSaver Act and relevantly states:

> **salary or wages**, in relation to any person, means salary or wages as defined in section RD 5(1)(a) to (c) of the Income Tax Act 2007 (whether the salary or wages are primary or secondary employment earnings) except that, in this Act,—
>
> (a) it excludes—
>
> …
>
> (vi) the amount of a benefit that an employee receives under section CE 2 of the Income Tax Act 2007 under an employee share scheme when the amount is treated as an amount of extra pay of the employee:
>
> (b) it includes extra pay (as defined in section YA 1 of the Income Tax Act 2007), unless—
>
> (i) otherwise excluded under paragraph (a) of this definition; or
>
> (ii) the amount is a redundancy payment for the purposes of the Income Tax Act 2007.

22 Section 4 ("salary or wages").

23 See Part 3, subpart 1 (Deductions of contributions from salary or wages) of the KiwiSaver Act.

24 See Part 3, subpart 3A (Compulsory employer contributions to KiwiSaver schemes and complying superannuation funds) of the KiwiSaver Act.

123. As a starting point, "salary or wages" for KiwiSaver purposes means salary or wages as defined in s RD 5(1)(a) to (c), which relevantly states:

> **RD 5 Salary or wages**
>
> *Meaning*
>
> (1) **Salary or wages—**
>
> (a) means a payment of salary, wages, or allowances made to a person in connection with their employment; and
>
> (b) includes—
>
> …
>
> (c) does not include—
>
> …
>
> (ii) an extra pay:
>
> …

124. "Salary or wages" in s RD 5 does not include an extra pay (s RD 5(1)(c)(ii)). In contrast, para (b) of the definition of "salary or wages" in the KiwiSaver Act includes an extra pay in salary or wages for the purposes of that Act. But it does not include an extra pay that is otherwise excluded from being "salary or wages" under para (a). Paragraph (a)(vi) excludes:

> the amount of a benefit that an employee receives under section CE 2 of the Income Tax Act 2007 under an employee share scheme when the amount is treated as an amount of extra pay of the employee:

125. A cash-settled ESS benefit is a benefit that an employee receives under s CE 2 of the Income Tax Act and it is treated as an amount of extra pay under s RD 7(1)(a). Therefore, a cash-settled ESS benefit is excluded from the definition of salary or wages for KiwiSaver purposes. As such, an employer is not required to make deductions or employer contributions in relation to a cash-settled ESS benefit.

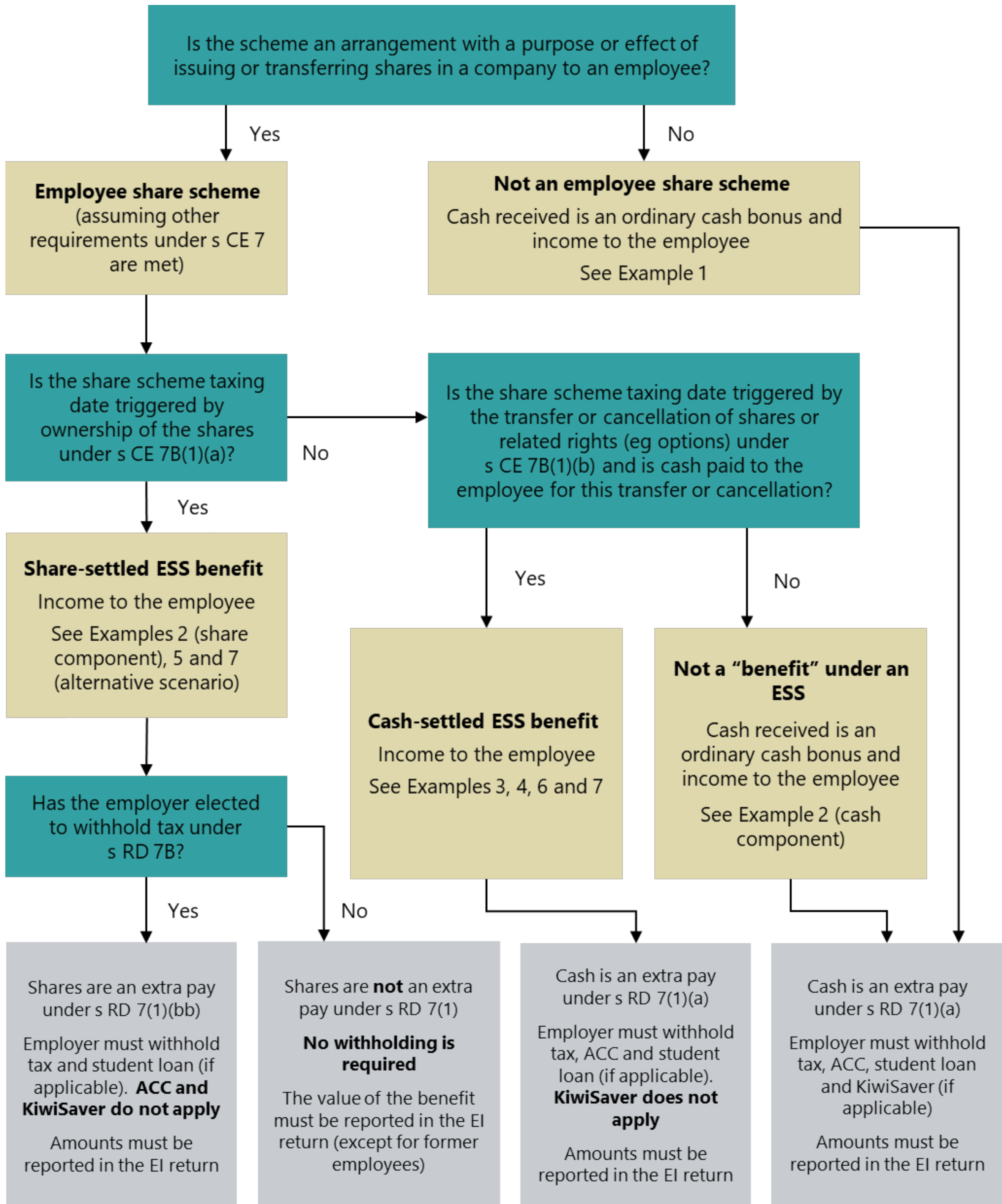
126. For completeness, an employer is not required to make KiwiSaver deductions or employer contributions in relation to a share-settled benefit where the employer has elected to withhold tax. In this situation the share-settled benefit is treated as an extra pay under s RD 7(1)(bb) and is excluded from the definition of salary or wages for KiwiSaver purposes.

127. In summary, an employer is not required to make KiwiSaver deductions or employer contributions in relation to a cash-settled ESS benefit. This outcome arises because KiwiSaver deductions and contributions are based on an employee's gross salary or wages and a cash-settled ESS benefit is excluded from the definition of "salary or wages" for the purposes of the KiwiSaver Act.

Overall summary

128. Figure | Hoahoa 1 sets out the key questions relevant to determining an employer's PAYE, student loan and KiwiSaver obligations for awards provided to an employee under a share scheme (including a phantom share scheme). It only considers awards provided to an employee under a share scheme – it does not consider other payments made as part of the arrangement such as a bonus to repay a loan used to purchase shares.

Figure | Hoahoa 1: Key questions to determine employer obligations for awards provided to an employee under a share scheme



Examples | Tauira

Example | Tauira 1 – Phantom share scheme

After a successful performance review, Ellen receives a letter from her employer Garments Ltd inviting her to participate in the company's employee share plan. The letter grants her 1,000 Restricted Stock Units (RSUs). The market value of Garments' shares is $10 on grant date. The RSUs will vest after 3 years. Ellen does not pay anything for the RSUs. Ellen will forfeit the RSUs if she leaves Garments within 3 years of the grant date.

The letter and the share plan rules state the RSUs are virtual shares that conditionally entitle Ellen to receive a cash payout corresponding to the value of a real share on the vesting date. The RSUs do not entitle Ellen to ownership of Garments' shares, voting rights or dividend payments.

Ellen continues to be an employee of Garments and the RSUs vest 3 years after the grant date. The market value of Garments' shares on the vesting date is $50. Ellen receives a payment of $50,000 in the month after the RSUs vest.

Although the arrangement mimics an ESS, the fact that the RSUs are virtual, and Ellen receives a cash payout and is not entitled to become a shareholder under the plan, means that the plan is **not an "employee share scheme"** for tax purposes. The arrangement does not have "a purpose or effect of issuing or transferring shares" in a company to an employee.

The payment is a cash bonus or extra pay and is income to Ellen under s CE 1(1)(a). It is an extra pay under s RD 7(1)(a) and a PAYE income payment. Garments Ltd will have the usual PAYE (including ACC), student loan and KiwiSaver obligations.

Example | Tauira 2 – Incentive scheme involving a combination of cash and shares

Jaya, an employee of Research Ltd, receives an award letter advising that she is eligible to participate in the company's incentive scheme. The incentive scheme has both a cash and a share component.

Jaya's maximum incentive under the scheme is $50,000. She will receive this as 50% cash and 50% shares, to the extent that she meets specific performance goals for the financial year.

Jaya meets all of her performance goals and receives $25,000 cash and $25,000 of Research Ltd's shares.

The arrangement is an "employee share scheme". It is connected to Jaya's employment and it has **a** purpose or effect of transferring shares in Research Ltd to Jaya. At the time the arrangement is entered into, an objective effect of the arrangement is to transfer cash and shares to Jaya, so there is **a** purpose of transferring shares.

The shares Jaya receives are a benefit under an ESS. The share scheme taxing date for the share component is triggered by share ownership under s CE 7B(1)(a). The value of the benefit calculated under s CE 2(1) is $25,000 (ie the market value of the shares on the share scheme taxing date). The value of the **share-settled benefit** is income to Jaya under s CE 1(1)(d). Research Ltd can choose whether to withhold tax on the value of the benefit under ss RD 7(1)(bb) and RD 7B. If it chooses to withhold tax, student loan deductions will also apply (if any). ACC and KiwiSaver do not apply to a share-settled ESS benefit. No matter whether Research Ltd withholds tax or not, it must report the value of the benefit in its EI return.

The cash payment does not give rise to a "benefit" under an ESS. This is because the cash component does not trigger the share scheme taxing date under s CE 7B(1); it does not provide share ownership and it is not paid in relation to a transfer or cancellation of shares or related rights under the scheme. Accordingly, it does not give rise to a benefit under s CE 2(1). The cash is paid in satisfaction of the right to cash granted to Jaya.

The cash payment is still income to Jaya under s CE 1(1)(a) as a bonus or extra pay. The cash payment will be an extra pay under s RD 7(1)(a) and a PAYE income payment. As it is a PAYE income payment, Research Ltd will have the usual PAYE (including ACC), student loan and KiwiSaver obligations. The exemptions for ACC and KiwiSaver do not apply because the payment is not a benefit under an ESS.

Example | Tauira 3 – Option scheme, employer reserves the right to pay cash

Rawiri is employed by Gumboots Ltd. On 30 March 2017 Gumboots Ltd grants Rawiri options to buy 1,000 shares in Gumboots Ltd. The exercise price is $1 per option, which is the market value of the shares on grant date. Rawiri has 10 years to exercise the options. If Rawiri exercises the options, company management reserves the right to cancel the options and pay Rawiri the cash equivalent (ie the market value of the shares at the time less the exercise price).

The options are provided in relation to Rawiri's employment with Gumboots Ltd. Rawiri will forfeit the options if he ceases employment within 3 years of the date of grant.

Rawiri stays employed for 3 years and the options vest. Five years later Rawiri decides to exercise his options and gives the required notification to Gumboots Ltd. The market value of the shares at that time is $25. Gumboots Ltd exercises its right to cancel the options and pays Rawiri the cash equivalent (ie $24,000).

The arrangement is an "employee share scheme". It is connected to Rawiri's employment and it has **a** purpose or effect of transferring shares in the company to Rawiri even though Gumboots Ltd can choose to cancel the options and pay Rawiri the cash equivalent. At the time the arrangement is entered into, an objective effect of the arrangement is to transfer cash or shares to Rawiri, so there is **a** purpose of transferring shares.

In this situation the share scheme taxing date is triggered by the cancellation of the options under s CE 7B(1)(b).

The payment gives rise to a benefit under s CE 2(1). The amount of the benefit is the amount of consideration paid to Rawiri in relation to the cancellation of the share options under the ESS (ie $24,000).

The amount of the benefit is income to Rawiri under s CE 1(1)(d). As Rawiri received cash (and not shares), the payment is **a cash-settled ESS benefit**.

A cash-settled ESS benefit is an extra pay under s RD 7(1)(a) and a PAYE income payment. Gumboots Ltd will have the usual PAYE (including ACC) and student loan obligations that apply to an extra pay. Gumboots Ltd does not have any KiwiSaver obligations in relation to a cash-settled ESS benefit.

Example | Tauira 4 – Option scheme, employee chooses to receive cash

Marie is employed by Travel Ltd, a publicly listed company. Travel Ltd grants Marie options to buy 1,000 shares in Travel Ltd. The exercise price is $1 per option, which is the market value of the shares on grant date. The options will vest the following year if the company meets its financial targets and Marie remains employed by Travel Ltd. Marie will have 3 years to exercise the options. Alternatively, she can choose to receive a cash equivalent during the 3-year exercise period. If Marie chooses to take cash, Travel Ltd will cancel the options in return for a cash payment equal to the market value of the shares at the time less the exercise price. It is the company's preference that employees exercise the options rather than take cash because the objective of the scheme is to incentivise employees through company ownership. The company offers a cash payout alternative for those employees who do not wish to own shares.

The company meets its financial targets, Marie remains employed and the options vest. Two years later, Marie decides to take a cash payout. The market value of the shares at that time is $10 per share. Marie receives a cash payment of $9,000.

The arrangement is an "employee share scheme". It is connected to Marie's employment and it has **a** purpose or effect of transferring shares in the company to Marie even though Marie can choose to receive cash instead of shares. At the time the arrangement is entered into, an objective effect of the arrangement is to transfer shares to Marie, so there is **a** purpose of transferring shares.

In this situation the share scheme taxing date is triggered by the cancellation of the options under s CE 7B(1)(b).

The payment gives rise to a benefit under s CE 2(1). The amount of the benefit is the amount of consideration paid to Marie in relation to the cancellation of the share options under the ESS (ie $9,000).

The amount of the benefit is income to Marie under s CE 1(1)(d). As Marie received cash (and not shares), the payment is **a cash-settled ESS benefit**.

A cash-settled ESS benefit is an extra pay under s RD 7(1)(a) and a PAYE income payment. Travel Ltd will have the usual PAYE (including ACC) and student loan obligations that apply to an extra pay. Travel Ltd does not have any KiwiSaver obligations in relation to a cash-settled ESS benefit.

Example | Tauira 5 – Sale of company, share-settled benefit

Steve is a key employee of Tech Ltd, a privately owned company. Tech Ltd invites Steve to participate in the company incentive scheme. Steve is granted options to purchase 100,000 shares in Tech Ltd. The exercise price is $1 per share, which is the fair market value of the shares on grant date. The options will vest in 4 years if Steve is still an employee of Tech Ltd. If Steve leaves the company, any options that have not vested will be forfeited. Steve has 5 years from the vesting date to exercise the options.

The terms of the scheme state that if the company is sold to a third party, vesting will be accelerated and occur on the date of the sale, and Steve will be required to exercise his options and then sell and transfer all of his shares to the purchaser. Tech Ltd will receive the purchase price of the shares, deduct the exercise price and pay the balance to Steve.

Three years after Steve is granted the options, Tech Ltd is sold to an unrelated third party for $3 per share (which is market value). On the date of the sale, Steve's options vest, he exercises them, the shares are issued and then sold and transferred to the purchaser. Tech Ltd pays Steve the purchase price less the exercise price.

The scheme is an "employee share scheme". It is an arrangement with a purpose or effect of issuing or transferring shares in Tech Ltd to Steve and the arrangement is connected to Steve's employment.

In this situation, the share scheme taxing date is triggered by the issue of the shares to Steve under s CE 7B(1)(a) and therefore it is a **share-settled benefit**.

The value of the benefit calculated under s CE 2(1) is $200,000 (ie the market value of the shares on the date they are issued to Steve less the exercise price).

The amount of the benefit is income to Steve under s CE 1(1)(d). Tech Ltd can choose whether to withhold tax from the benefit under ss RD 7(1)(bb) and RD 7B. If Tech Ltd chooses to withhold tax it must also deduct student loan repayments (if any) but ACC earners' levy and KiwiSaver do not apply.

If Tech Ltd does not choose to withhold tax, Tech Ltd is still required to report the value of the benefit in its EI return on the relevant date.

Example | Tauira 6 – Sale of company, cash-settled benefit

The facts are the same as in Example | Tauira 6 except that, instead of specifying that Tech Ltd issues shares to Steve and then immediately sells them to the purchaser, the terms of the scheme state that if the company is sold to a third party, vesting will be accelerated and the vested options will be cancelled in return for a cash payment equivalent to the sale price of the shares less the exercise price.

Three years after Steve is granted the options, Tech Ltd is sold to an unrelated third party for market value. The vesting of Steve's options is accelerated and the unexercised options are cancelled in return for a cash payment equal to the market value of the shares less the exercise price.

In this situation, the share scheme taxing date is triggered by the cancellation of the options under s CE 7B(1)(b).

The payment gives rise to a benefit under s CE 2(1). The amount of the benefit is the amount of consideration paid to Steve in relation to the cancellation of the share options under the ESS.

The amount of the benefit is income to Steve under s CE 1(1)(d). As Steve received cash (and not shares), the payment is **a cash-settled ESS benefit**.

A cash-settled ESS benefit is an extra pay under s RD 7(1)(a) and a PAYE income payment. Tech Ltd will have the usual PAYE (including ACC) and student loan obligations that apply to an extra pay. Tech Ltd does not have any KiwiSaver obligations in relation to a cash-settled ESS benefit.

Example | Tauira 7 – Employee retires

Billie is a senior executive at Sneakers Ltd. She has been participating in Sneakers Ltd's long term incentive plan (LTI) for the past five years. Under the plan, every year, Billie is granted a right to acquire 1,000 shares in Sneakers Ltd at no cost. The rights vest after three years if certain performance hurdles are met by the company at the end of the vesting period (which aligns with the end of the company's financial year on 31 March).

If Billie leaves the company for any reason other than redundancy or retirement, any unvested rights are forfeited. If Billie is made redundant or retires, any unvested rights will be cancelled but she will be entitled to a cash payment in relation to the cancelled rights under a formula in the plan.

Billie retires on 31 December 2023. Under the terms of the plan the board determines the amount of the cash payment that Billie will receive for the cancellation of the unvested rights and makes that payment to Billie.

The payment is a **cash-settled ESS benefit** (ie it is a benefit received under an ESS that is provided in cash rather than shares). This outcome arises because:

- The LTI is an "employee share scheme". It is an arrangement with a purpose or effect of issuing or transferring shares in Sneakers Ltd to Billie and the arrangement is connected to Billie's employment.
- The share scheme taxing date is triggered by the cancellation of rights under s CE 7B(1)(b).
- A cash payment is made to Billie for the cancellation of the unvested rights and the payment gives rise to a benefit under s CE 2(1).

The amount of the benefit is income to Billie under s CE 1(1)(d).

A cash-settled ESS benefit is an extra pay under s RD 7(1)(a) and a PAYE income payment. Sneakers Ltd will have the usual PAYE (including ACC) and student loan obligations that apply to an extra pay. Sneakers Ltd does not have any KiwiSaver obligations in relation to a cash-settled ESS benefit.

Alternative scenario

On retirement, the terms of the plan allow Billie to remain in the plan to the extent she still has rights under the plan. No new rights are granted. Under the plan there is a formula to determine how many of the unvested rights are eligible to vest (based on the number of days Billie was with the company during the vesting period). Any remaining rights are forfeited. If the performance hurdles are met Billie will receive shares in the company on the usual dates.

In this situation, if the performance hurdles are met Billie will receive a **share-settled benefit**. This outcome arises because the share scheme taxing date is triggered by share ownership under s CE 7B(1)(a). The market value of the shares on the share scheme taxing date will give rise to a benefit under s CE 2(1).

Billie will be a former employee when any shares vest. This means Sneakers Ltd will not be required to report the value of the benefit in its EI return (unless it elects to withhold tax). However, the benefit will be taxable income to Billie under s CE 1(1)(d) and she will be required to include the value of the benefit in her tax return.

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Taxation (Transformation: First Phase Simplification and Other Measures) Bill (Regulatory Impact Statements, Policy and Strategy, Inland Revenue, June 2015) **taxpolicy.ird.govt.nz/publications/2015/2015-ris-tfpsom-bill**

IS 24/06: PAYE – How an employer funds the tax cost on an employee share scheme benefit

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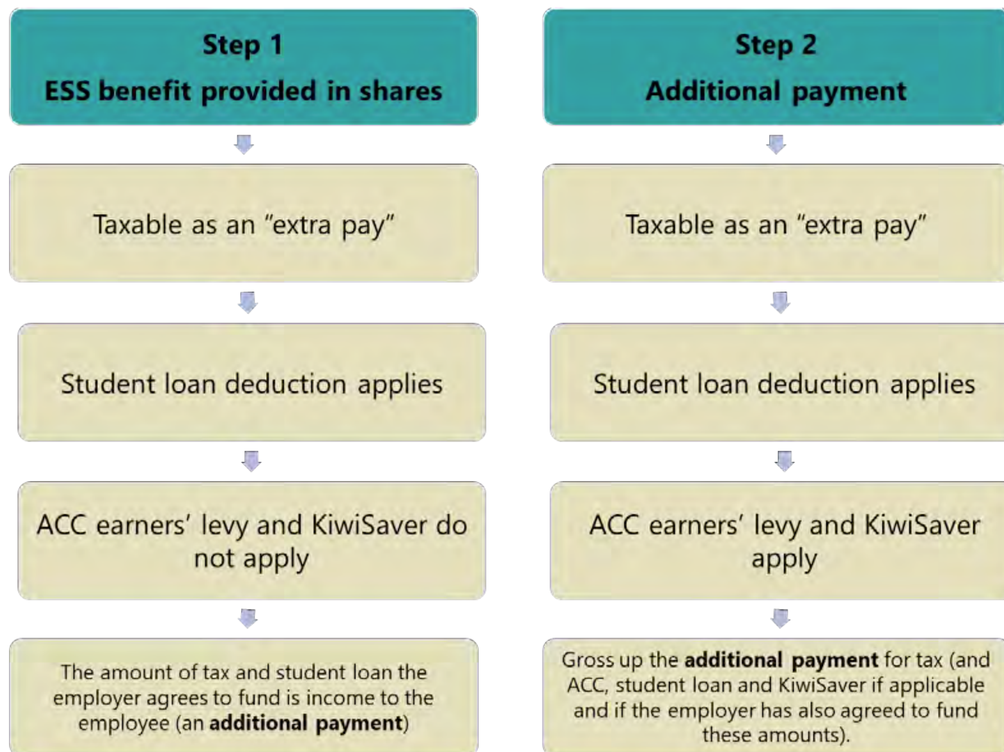
This interpretation statement explains an employer's withholding and reporting obligations related to PAYE, student loans and KiwiSaver if an employer wants to fund the cost of tax (and student loan, if applicable) on an employee share scheme benefit provided in shares.

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

Summary | Whakarāpopoto

1. This interpretation statement explains an employer's PAYE, student loan and KiwiSaver obligations where an employer wants to fund the cost of tax on an employee share scheme (ESS) benefit provided in **shares**.
2. It is unlikely that an employer would fund the cost of tax on an ESS benefit provided in cash. For this reason, this interpretation statement does not consider that situation.
3. An ESS benefit is income to an employee. Where an employer provides the benefit in shares (ie a non-cash benefit), it is not required to withhold tax from the benefit and in that case the employee pays tax on the benefit through the end-of-year tax return process.
4. To simplify the end-of-year tax return process for the employee, an employer might choose to withhold tax from the ESS benefit under the PAYE rules. When an employer chooses to withhold tax from an ESS benefit that it provides in shares, the benefit in shares is treated as an "extra pay" and a PAYE income payment from which the employer is required to withhold tax at the relevant extra pay tax rate. If the employee has a student loan, the employer may need to make a student loan deduction. Accident Compensation Corporation (ACC) earners' levy and KiwiSaver deductions (and contributions) do not apply to an ESS benefit provided in shares.
5. As the ESS benefit is in shares and a non-cash benefit, the tax withheld will need to be funded in some way. If the employer has not agreed to fund the tax payment, it will need to be funded by the employee. For example, the employer and employee may agree that, to fund the tax the employer will deduct it from the employee's net salary or sell a portion of the shares on behalf of the employee.
6. Alternatively, the employer may agree to fund the tax (and any student loan deduction, if applicable) on the ESS benefit. The additional payment that an employer makes to fund the cost of the tax on an ESS benefit (and a student loan deduction, if applicable) is itself an "extra pay". As an extra pay, it is income to the employee and a PAYE income payment from which the employer is required to withhold tax at the relevant extra pay tax rate.
7. The employer may also be required to withhold ACC earners' levy and make student loan and KiwiSaver deductions (and contributions) in relation to the additional payment. The exclusions from ACC earners' levy and KiwiSaver deductions (and contributions) that apply to the ESS benefit do not apply to the additional payment because the additional payment is not itself an ESS benefit for tax purposes. The employer will need to consider whether it wants to fund the cost of ACC earners' levy and KiwiSaver deductions on the additional payment.
8. If the employer wants to ensure that the employee does not have to fund the cost of the tax (or other deductions) on the ESS benefit and the additional payment, it must gross up any additional payment it makes for any resulting tax, student loan, ACC earners' levy and KiwiSaver. This outcome arises because the employer is providing the employee with a further benefit (the additional payment) that is assessable income to the employee. As a result, further tax (and student loan, if applicable) is payable, and ACC earner's levy and KiwiSaver deductions (and contributions) may also apply to the additional payment.
9. Figure | Hoahoa 1 illustrates these obligations.

Figure | Hoahoa 1: Summary of the tax consequences when an employer elects to withhold tax from an ESS benefit provided in shares and agrees to fund the cost of the tax (and potentially other deductions).



10. If an employer wants to fund only the tax (and ACC earners' levy, if applicable) and not student loan or KiwiSaver deductions (if any), then it should inform the employee that the employer will need to make a deduction from the employee's net salary or wages to cover the student loan and KiwiSaver deductions.
11. To the extent that an employer is required to separately identify the amount of the ESS benefit in its employment income information, this amount should not include an additional payment made to fund tax (and student loan deduction, if applicable) on the ESS benefit. An additional payment of this nature is not part of the ESS benefit for tax purposes.
12. Examples illustrating the points discussed in this interpretation statement follow from [72].

Introduction | Whakataki

Background

13. Generally, where an employee receives a benefit under an employee share scheme (ESS), their employer provides it in **shares** (ie it is a non-cash benefit). The amount of the benefit is income to the employee and the employee pays tax on the benefit through the end-of-year tax return process (and through provisional tax, if applicable).[1] See Example | Tauira 1.
14. An employer is not required to withhold tax on an ESS benefit provided in shares. However, an employer can choose to withhold tax under the PAYE rules. Withholding tax simplifies the end-of-year tax process for the employee.
15. If an employer decides to withhold tax, it also needs to think about how that tax will be paid given that shares are a non-cash benefit. Specifically, it needs to consider whether it will be the employee or the employer that funds the payment of the tax.
16. If it is intended that the employee should bear the cost of the withholding, the employer and the employee will need to agree how the tax will be paid. Possible alternatives include the employer deducting the tax from the employee's salary or selling a portion of the shares on behalf of the employee.

1 For more information about how receiving an ESS benefit that is not taxed at source affects an employee, see **QB 23/05: Provisional tax – impact on salary or wage earners who receive a one-off amount of income without tax deducted** *Tax Information Bulletin* Vol 35, No 5 (June 2023).

17. In some situations, an employer may want to fund the payment of the tax. It might do this so that the employee does not have to sell shares or fund the payment of the tax from their usual net salary. Ultimately whether the employer or the employee funds the tax will depend on what they agree between them.
18. In some circumstances, an employer provides an ESS benefit in cash.[2] In this situation, the PAYE rules require an employer to withhold tax. As the employer pays the benefit in cash, it would generally deduct tax from the payment under the PAYE rules in the usual way. As it is unlikely an employer would fund the payment of tax where it provides the ESS benefit in cash, this interpretation statement does not consider that situation.
19. Where an employer elects to withhold tax from an ESS benefit it provides in shares, it is also required to make a student loan deduction, if applicable. If the employee has a student loan, then the employer will need to consider whether it will fund the cost of the student loan deduction or whether the employee will fund this cost.
20. KiwiSaver and Accident Compensation Corporation (ACC) earners' levy do not apply to an ESS benefit that an employer provides in shares. However, where the employer bears the cost of tax (and student loan deduction, if applicable) on an ESS benefit, KiwiSaver and ACC earners' levy may apply to that additional payment.
21. This interpretation statement explains an employer's withholding and reporting obligations related to PAYE, student loans and KiwiSaver where an employer:
    - has elected to withhold tax in relation to an ESS benefit provided in **shares**; and
    - has agreed to fund the cost of the tax (and potentially other obligations).
22. While this statement is focused on the situation where an employer agrees to fund the cost of the tax, an example of the situation where an employer has elected to withhold but has not agreed to fund the cost of the tax can be found at Example | Tauira 3.

What this statement covers

23. For ease of reference, this statement uses **additional payment** to mean the amount of tax (and student loan deduction, if applicable) that the employer funds on an ESS benefit.
24. This statement covers:
    - the nature of the additional payment;
    - an employer's PAYE, student loan and KiwiSaver obligations;
    - when an employer must gross up the additional payment;
    - how an employer calculates a gross up;
    - an employer's obligations in reporting the additional payment; and
    - examples illustrating the points discussed.
25. Generally, a child support deduction notice will not apply to an ESS benefit or an additional payment to fund the tax (and student loan, if any) on the ESS benefit. However, if an employer has any questions about whether to make a child support deduction, they should contact Inland Revenue. This statement does not consider child support deductions any further.

2 For more information on ESS benefits provided in cash, see **IS 24/05: Employer obligations for employee share scheme benefits paid in cash**.

Analysis | Tātari

The nature of the additional payment

26. When considering an employer's PAYE, student loan and KiwiSaver obligations in the situation where an employer is funding the tax (and student loan deduction, if applicable) on an ESS benefit, it is necessary to understand the nature of what the employer is providing to the employee.
27. An ESS benefit is income to an employee under s CE 1(1)(d). Where the benefit is in shares and the employer has elected to withhold tax under s RD 7B, then the benefit is treated as an "extra pay" under s RD 7(1)(bb).
28. An "extra pay" (s RD 7) and "salary or wages" (s RD 5) are payments made to a person in connection with their employment. Salary or wages are generally regular amounts, and an extra pay is generally a one-off amount. They are both "PAYE income payments" from which an employer is required to withhold tax under ss RA 5 and RD 3. They are defined separately because the amount of tax withheld from an extra pay is calculated differently to PAYE on salary or wages.
29. Where an employer is funding the tax payable on an ESS benefit (and student loan deduction, if applicable), then the question is whether this additional payment is also:
    - income to the employee; and
    - a PAYE income payment from which an employer is required to withhold tax.
30. Employment income is defined in s CE 1 and includes an "extra pay" under s CE 1(1)(a) and an employee share scheme benefit under s CE 1(1)(d).

> **CE 1 Amounts derived in connection with employment**
>
> *Income*
>
> (1) The following amounts derived by a person in connection with their employment or service are income of the person:
>
> (a) salary or wages or an allowance, bonus, extra pay, or gratuity:
>
> …
>
> (d) a benefit received under an employee share scheme:
>
> …

31. Section RD 7(1)(a) contains the general definition of an "extra pay".

> **RD 7 Extra pay**
>
> Meaning
>
> (1) An **extra pay**—
>
> (a) means a payment that—
>
> (i) is made to a person in connection with their employment; and
>
> (ii) is not a payment regularly included in salary or wages payable to the person for a pay period; and
>
> (iii) is not overtime pay; and
>
> (iv) is made in 1 lump sum or in 2 or more instalments; and
>
> …
>
> (d) does not include a payment of exempt income.
>
> …

32. The additional payment the employer makes meets the requirements of s RD 7(1)(a). It is a payment made to a person (which is then applied to their tax and student loan accounts) and it is made in connection with their employment (it relates to an ESS benefit). As a one-off payment, it is not a payment regularly included in the employee's salary or wages and is generally made in one lump sum. It is not overtime pay. It is unlikely to be a payment of exempt income (see subparts CW and CZ for exempt income provisions).
33. Accordingly, the additional payment is an "extra pay" as defined in s RD 7(1)(a). As an "extra pay", it is income to the employee under s CE 1(1)(a) and a PAYE income payment from which an employer must withhold tax under ss RA 5 and RD 3.

34. It is important to note that the additional payment is not part of the ESS benefit for tax purposes. For tax purposes, the amount of the ESS benefit is determined under s CE 2(1) and (2).

> **CE 2 Benefits under employee share schemes**
>
> *Benefit*
>
> (1) A person who is an employee share scheme beneficiary described in section CE 7(a)(i) or (ii) receives a benefit for the purposes of section CE 1(1)(d) in relation to shares or related rights under the employee share scheme equal to the positive amount calculated on the share scheme taxing date using the formula—
>
> share value − consideration paid + consideration received − previous income
>
> *Definition of items in formula*
>
> (2) In the formula in subsection (1),—
>
> (a) **share value** is the market value of the shares or related rights owned by an employee share scheme beneficiary on the share scheme taxing date, if the share scheme taxing date is not triggered by a transfer or cancellation of the shares or related rights:
>
> (b) **consideration paid** is the amount of consideration paid or payable by an employee share scheme beneficiary in relation to the transfer of the shares or related rights under the employee share scheme:
>
> (c) **consideration received** is the amount of consideration paid or payable to an employee share scheme beneficiary in relation to a transfer or cancellation of the shares or related rights under the employee share scheme, not including relevant shares or related rights under a replacement employee share scheme:
>
> (d) **previous income** is the total amount of income under section CE 1(1)(d) that the employee share scheme beneficiary has in relation to the shares or related rights before the date that is 6 months after the date of Royal assent for the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018.
>
> …

35. Broadly, when an employee receives an ESS benefit in shares, the amount of the benefit is the market value of the shares on the share scheme taxing date less the amount paid for the shares (if anything).

36. The additional payment to fund the tax on the ESS benefit (and student loan deduction, if applicable) is not part of the "share value" and neither is it "consideration received". "Consideration received" deals with amounts paid for the transfer or cancellation of shares or related rights held by an employee under an ESS when the share scheme taxing date is triggered by the transfer or cancellation of the shares or related rights (rather than the ownership of shares).

37. The fact that the additional payment is not part of the ESS benefit for tax purposes means that any special rules that apply to an ESS benefit generally do not apply to the additional payment. For further discussion of the impact of this conclusion, see [46] in relation to ACC earners' levy and [55] on KiwiSaver.

An employer's PAYE, student loan and KiwiSaver obligations

38. This section considers an employer's obligations to deduct PAYE (including ACC earners' levy), student loan repayments and KiwiSaver from:

- an ESS benefit where the employer has elected to withhold tax; and
- an additional payment an employer makes to fund the tax on the ESS benefit.

Income tax

39. As discussed at [27], when an employer elects to withhold tax from an ESS benefit, then the benefit is treated as an "extra pay" and a PAYE income payment from which an employer is required to withhold tax.

40. Likewise, as concluded at [33], an additional payment that an employer makes to fund the tax (and student loan deduction, if applicable) on an ESS benefit is also an "extra pay" and a PAYE income payment from which an employer is required to withhold tax.

41. Tax on the ESS benefit and the additional payment is calculated at the employee's extra pay tax rate. The extra pay tax rate is generally determined under s RD 17 and sch 2, part B. Broadly, an employee's extra pay tax rate is the marginal tax rate based on the sum of the employee's annualised salary and the amount of the extra pay. In some circumstances an employee can choose to have an extra pay taxed at a marginal tax rate higher than the one calculated by their employer under s RD 17 (s RD 10).

42. More information about calculating tax on an extra pay is available in the current Weekly and fortnightly PAYE deduction tables – **IR340**, Four-weekly and monthly PAYE deduction tables – **IR341**, the Employer's Guide – **IR335**, in **Tax Information Bulletin Vol 36 No 4 (May 2024)**: 131 and on our website – **Calculate PAYE for a lump sum payment**.

ACC earners' levy

43. The Accident Compensation Act 2001 (ACC Act) sets out an employer's obligations for collecting ACC earners' levy.

44. An employer collects ACC earners' levy by making a deduction from an employee's "earnings" (s 221, ACC Act). "Earnings" include "earnings as an employee", which means all PAYE income payments (as defined in s RD 3(1)) of the person for the tax year (ss 6 and 9, ACC Act). Section 11 of the ACC Act then excludes from "earnings as an employee" any benefit arising from an ESS under s CE 2 when the employer makes an election under s RD 7B to withhold and pay tax in relation to the benefit.

45. Accordingly, an employer is not required to deduct ACC earners' levy from an ESS benefit that it provides in shares because the benefit is excluded from being "earnings" for the purposes of the ACC Act.

46. However, as discussed from [34] to [37], the additional payment made to fund the cost of the tax (and student loan deduction, if applicable) on an ESS benefit is not itself an ESS benefit. Therefore, it will be "earnings" for the purposes of the ACC Act (as it is not otherwise excluded). This means that an employer will be required to deduct ACC earners' levy from the additional payment (unless, broadly, the sum of the employee's annualised salary and the additional payment is higher than the maximum amount of income that ACC earners' levy is charged on). ACC earners' levy rates and maximum earnings thresholds can be found on our website – **ACC earners' levy rates**.

Student loan

47. The Student Loan Scheme Act 2011 (SLS Act) sets out an employer's obligations for collecting student loan repayments under ss 36 and 37.

48. An employer collects student loan repayments by making a deduction from an employee's "salary or wages", which includes an "extra pay" under the SLS Act.[3] The definition of "salary or wages" in the SLS Act does not exclude an ESS benefit.

49. Accordingly, an employer is required to deduct student loan repayments from an ESS benefit and any additional payment.

50. As discussed at [19], where an employer wants to fund the tax on an ESS benefit provided in shares (ie a non-cash benefit) and the employee has a student loan, then the employer needs to consider whether it also wants to fund the cost of the student loan deduction. If the employer does not agree to fund the student loan deduction, the employee must fund it (eg the employee may agree to the employer deducting the amount from their salary, or the employee may pay the student loan amount out of their net salary).

KiwiSaver

51. The KiwiSaver Act 2006 (KiwiSaver Act) sets out an employer's KiwiSaver obligations.

52. Broadly, if an employee is a KiwiSaver member and is not on a savings suspension (ie is not taking a break from making KiwiSaver contributions), then their employer is required to deduct KiwiSaver at the employee's contribution rate from the employee's gross salary or wages. An employer is also generally required to make a compulsory employer contribution based on an employee's gross salary or wages.

53. Section 4 of the KiwiSaver Act defines "salary or wages". It relevantly states:

> **salary or wages**, in relation to any person, means salary or wages as defined in section RD 5(1)(a) to (c) of the Income Tax Act 2007 (whether the salary or wages are primary or secondary employment earnings) except that, in this Act,—
>
> (a) it excludes—
>
> …
>
> (vi) the amount of a benefit that an employee receives under section CE 2 of the Income Tax Act 2007 under an employee share scheme when the amount is treated as an amount of extra pay of the employee:
>
> (b) it includes extra pay (as defined in section YA 1 of the Income Tax Act 2007), unless—
>
> (i) otherwise excluded under paragraph (a) of this definition; or
>
> (ii) the amount is a redundancy payment for the purposes of the Income Tax Act 2007.

3 Section 4 ("salary or wages").

54. It follows that an employer is not required to make KiwiSaver deductions or employer contributions in relation to an ESS benefit. This is because KiwiSaver deductions and contributions are based on an employee's gross salary or wages and an ESS benefit is expressly excluded from the definition of "salary or wages" in s 4 of the KiwiSaver Act.
55. However, as discussed from [34] to [37], any additional payment made to fund the cost of the tax (and student loan deduction, if applicable) on the ESS benefit is not itself an ESS benefit. Therefore, any additional payment made to fund the cost of tax (and student loan deduction, if applicable) on the ESS benefit will be "salary or wages" for the purposes of the KiwiSaver Act. This means that an employer may be required to make KiwiSaver deductions from or employer contributions on the additional payment.

Summary

56. When an employer elects to withhold tax from an ESS benefit provided in shares, the ESS benefit is treated as an "extra pay" from which the employer is required to withhold tax at the relevant extra pay tax rate. The employer may also be required to make a student loan deduction. ACC earners' levy and KiwiSaver deductions (and contributions) do not apply to the ESS benefit.
57. Any additional payment that the employer makes to fund the tax (and student loan deduction, if applicable) on the ESS benefit is also an "extra pay" from which the employer is required to withhold tax at the relevant extra pay tax rate. The employer may also be required to withhold ACC earners' levy and make student loan and KiwiSaver deductions (and contributions) in relation to the additional payment. The exclusions from ACC earners' levy and KiwiSaver that apply to the ESS benefit do not apply to the additional payment because the additional payment is not itself an ESS benefit for tax purposes.
58. When an employer wants to fund the tax on an ESS benefit, the employer will also need to consider whether it wants to fund the cost of any student loan deduction on the ESS benefit and the cost of ACC earners' levy, student loan and KiwiSaver deductions on the additional payment. If it does not, it will need to seek reimbursement of those amounts from the employee.

When an employer must gross up the additional payment

59. Whether an employer is required to gross up an additional payment depends on what has been agreed between the employer and the employee.
60. Where an **employer** has agreed to make a payment to fund the tax and any other deductions (ie ACC earners' levy, student loan and KiwiSaver) associated with the delivery of an ESS benefit to an employee, then the amount of the tax (and student loan deduction, if any) on the ESS benefit will be an additional payment to the employee. The employer must gross up that additional payment for PAYE (and student loan and KiwiSaver deductions, if any). This outcome arises because the employer is providing the employee with a further benefit (the tax and student loan payments) that is assessable income to the employee. As a result, further tax (and ACC earners' levy, student loan and KiwiSaver, if applicable) is payable. See Example | Tauira 2 and Example | Tauira 7.
61. Where an employer has agreed to fund only the PAYE on the ESS benefit and the additional payment (not student loan or KiwiSaver) then the amount of the additional payment is the amount of tax on the ESS benefit. The employer must gross up the additional payment for tax (and ACC earners' levy if applicable). Any student loan deduction on the ESS benefit and the additional payment and any KiwiSaver deduction on the additional payment would need to be funded by the employee. See Example | Tauira 6 and Example | Tauira 8.
62. The employer need not gross up if the **employee** is funding the cost of the tax on the ESS benefit. For example, this applies if the employer deducts the tax from the employee's net salary or sells a portion of the shares on the employee's behalf to fund the tax. In this case, the employee is not receiving any additional benefit from the employer and so no additional tax is payable. See Example | Tauira 3.

How an employer calculates a gross-up

63. The first step is for the employer to work out the amount of the additional payment. This amount will generally be the total of:
    - the tax on the ESS benefit at the appropriate extra pay tax rate; and
    - the amount of the student loan deduction on the ESS benefit (if applicable and if the employer has also agreed to fund this amount).

64. The next step is for the employer to “gross up” **the additional payment** for tax (and ACC earners’ levy, student loan and KiwiSaver deductions, if applicable and if the employer has also agreed to fund these amounts).

65. Some payroll software allows an employer to gross up the additional payment for the applicable amounts. However, in situations where an employer must calculate the value manually, it may use the following gross-up formula:

    Gross income = net income / (1 – tax rate)

66. The “net income” is the amount of the additional payment calculated at step 1 (see [63]). The “tax rate” (where an employer is funding the tax on an ESS benefit) is the appropriate extra pay tax rate for the employee. This is because the tax funded by the employer is a one-off amount and an “extra pay” under s RD 7 (see [29] to [33]). If the employer is funding more than one tax type (or deduction), such as a student loan as well as the tax on an ESS benefit, then it adds the tax rates together. See Example | Tauira 4, Example | Tauira 5 and Example | Tauira 7.

67. If an employer wants to fund only the tax (and ACC earners’ levy, if applicable) and not student loan or KiwiSaver deductions (if any), then it should inform the employee that it will need to make a deduction from the employee’s net salary or wages to cover any student loan and KiwiSaver deductions on the ESS benefit and the additional payment as applicable. See Example | Tauira 6 and Example | Tauira 8.

An employer’s reporting obligations

68. Section RD 22 requires an employer (or PAYE intermediary) to provide employment income information to the Commissioner.

69. Where an employer is required to separately identify the amount of the ESS benefit, this amount should not include an additional payment made to fund tax (and student loan deduction, if applicable) on the ESS benefit. As discussed from [34] to [36], an additional payment of this nature is not part of the ESS benefit for tax purposes.

70. On the basis that the date the employer makes the additional payment is likely to be the same date the ESS benefit is processed through payroll, then there should be no difference in the reporting date for the ESS benefit and the additional payment.

71. More information about an employer’s reporting obligations for an ESS benefit is on our website - **Filing employment information about ESS benefits**.

Examples | Tauira

72. The following examples illustrate the points discussed in this interpretation statement. All the examples use an extra pay tax rate of 33% and a KiwiSaver employee contribution rate of 6% (for KiwiSaver members) for ease of comparison but different rates may apply for different employees.

Example | Tauira 1 – No election to withhold tax

Joe receives some shares under an ESS from his employer, Legacy Ltd. He does not pay anything for the shares. The value of the ESS benefit is $10,000. The terms of the scheme state that no tax will be withheld from the ESS benefit (unless required by law) and that the payment of tax on the ESS benefit is Joe's responsibility.

Joe has a student loan and is a KiwiSaver member. Joe is not currently a provisional taxpayer.

Legacy Ltd reports the following amounts to Inland Revenue in its employment information (together with Joe's usual salary information, if applicable):

Employee share scheme earnings	$10,000
Earnings not liable for ACC earners' levy	$10,000

KiwiSaver does not apply to an ESS benefit.

Joe pays tax on the ESS benefit through the end-of-year tax return process. As Joe's tax to pay is not more than $5,000 (all his other income is taxed at source) Joe will not be a provisional taxpayer.

The ESS benefit may have implications for Joe's end-of-year student loan repayment obligations and requirements to make interim student loan repayments.

Other scenarios

If the value of the ESS benefit was higher and Joe had more than $5,000 tax to pay, he would need to consider provisional tax implications for the following year.

If the value of the ESS benefit was higher and Joe had $60,000 or more of tax to pay in the current year, Joe may be exposed to use-of-money interest.

Example | Tauira 2 – Employer funds the tax

Marie receives some shares under an ESS from her employer, Steady Ltd. She does not pay anything for the shares. The value of the ESS benefit is $10,000. The terms of the scheme state that Steady Ltd will withhold tax from the ESS benefit and fund the payment of the tax.

Marie does not have a student loan and is not a KiwiSaver member. Her annual salary is higher than the maximum liable earnings for ACC earners' levy.

Steady Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Marie of 33% ($10,000 × 33% = $3,300).

Steady Ltd must gross up the amount of $3,300. This is because Steady Ltd is providing Marie with a further benefit (the tax payment) that is an "extra pay" and assessable income to Marie. As a result, further tax is payable. Steady Ltd calculates the gross-up as follows:

Gross income =	$3,300.00 / (1 – 0.33)
	$3,300.00 / 0.67
	$4,925.37

Steady Ltd makes a payment of $4,925.37 to Marie in its payroll system and withholds tax of $1,625.37 at 33% ($4,925.37 × 33% = $1,625.37). The net amount of $3,300 is not paid to Marie's bank account, instead Steady Ltd makes a deduction for that amount and pays it to Inland Revenue as the tax on the ESS benefit.

Steady Ltd reports the following amounts to Inland Revenue in its employment information (together with Marie's usual salary information, if applicable):

Gross earnings	$4,925.00
Employee share scheme earnings	$10,000.00
Earnings not liable for ACC earners' levy	$10,000.00
PAYE deductions	$4,925.37 ($3,300 + $1,625.37)

The additional payment of $4,925.37 that Steady Ltd makes to Marie in its payroll system is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes. For reporting purposes, ESS earnings have their own separate field and are not included in the gross earnings field.

Other scenarios

If Steady Ltd had processed the ESS benefit of $10,000 through its payroll system and paid the tax of $3,300 for Marie without doing anything further, this would have been incorrect. The payroll system would show income of $10,000 and tax of $3,300, leaving a net amount of $6,700. This outcome is incorrect because Marie actually received a net amount of $10,000.

If Steady Ltd had limited its additional payment to $3,300, this amount would still be income to Marie and subject to tax. Steady Ltd must report the $3,300 as additional income to Marie. As Steady Ltd would only be funding the tax on the ESS benefit and not on the additional payment, Marie would need to fund the tax on the additional payment. For example, that tax could be deducted from her net salary or wages.

Example | Tauira 3 – Employee funds the tax

Nate receives some shares under an ESS from his employer, Rapid Ltd. He does not pay anything for the shares. The value of the ESS benefit is $10,000. The terms of the scheme state that Rapid Ltd will elect to withhold tax from the benefit and that Nate can choose whether to fund the tax through a deduction from his net salary or the sale of a portion of the shares.

Nate does not have a student loan and is not a KiwiSaver member. His annual salary is $156,000 which is higher than the maximum liable earnings for ACC earners' levy.

Nate chooses to fund the tax through a deduction from his net salary which he agrees to in writing. Rapid Ltd calculates the tax on the ESS benefit using the appropriate extra pay tax rate for Nate of 33%. The result is as follows:

ESS benefit	$10,000
Tax at 33%	$3,300
Net income	$6,700

Although Nate has received $10,000 worth of shares, Rapid Ltd has deducted $3,300 from his usual net salary payment. Therefore, Nate has received a net benefit of $6,700. Nate's payslip for his next fortnightly salary payment shows:

Payments	
Salary	$6,000.00
Deductions	
PAYE	$1,718.32
Tax on ESS benefit	$3,300.00
Net amount	$981.68

If Nate had chosen to sell a portion of his shares to fund the tax, Rapid Ltd would have sold $3,300 worth of shares on Nate's behalf and Nate would have received $6,700 worth of Rapid Ltd shares. The overall outcome would be the same: that is, the value of the ESS benefit would be $10,000 and Nate would receive a net benefit of $6,700.

The employer need not gross up in either of these situations because the employee is funding the cost of the tax.

Rapid Ltd reports the following amounts to Inland Revenue in its employment information (regardless of whether the tax is funded by a deduction from Nate's usual net salary or the sale of shares).

Gross earnings	$6,000.00
Employee share scheme earnings	$10,000.00
Earnings not liable for ACC earners' levy	$10,000.00
PAYE deductions	$5,018.32 ($3,300 + $1,718.32)

For reporting purposes, ESS earnings have their own separate field and are not included in the gross earnings field.

Other scenarios

If Nate had a student loan, the student loan deduction on his ESS benefit would also need to be deducted from his usual net salary payment (or more shares would need to be sold to fund the student loan repayment).

If Nate was a KiwiSaver member there would be no impact on the above calculation as KiwiSaver does not apply to an ESS benefit and Rapid Ltd is not funding the cost of the tax so there is no additional payment made to Nate.

Example | Tauira 4 – Employer funds tax and ACC earners' levy

Olivia receives some shares under an ESS from her employer, Steady Ltd. She does not pay anything for the shares. The value of the ESS benefit is $10,000. The terms of the scheme state that Steady Ltd will withhold tax from the ESS benefit and fund the payment of the tax.

Olivia's annual salary is below the maximum liable earnings for ACC earners' levy. She does not have a student loan and is not a KiwiSaver member.

Steady Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Olivia of 33% ($10,000 × 33% = $3,300). ACC earners' levy does not apply to an ESS benefit provided in shares.

Steady Ltd must gross up the amount of $3,300. This is because Steady Ltd is providing Olivia with a further benefit (the tax payment) that is an "extra pay" and assessable income to Olivia. As a result, further tax is payable. Olivia's annualised income plus the amount of the extra pay is below the maximum liable earnings for ACC earners' levy therefore ACC earners' levy at 1.60% applies to the whole of the additional payment. Steady Ltd calculates the gross-up as follows:

Gross income =	$3,300.00 / (1 – (0.33 + 0.016))
	$3,300.00 / (1 – 0.346)
	$3,300.00 / 0.654
	$5,045.87

Steady Ltd makes a payment of $5,045.87 to Olivia in its payroll system and withholds PAYE of $1,745.87 at 34.6% ($5,045.87 × 34.6% = $1,745.87). The net amount of $3,300 is not paid to Olivia's bank account, instead Steady Ltd makes a deduction for that amount and pays it to Inland Revenue as the tax on the ESS benefit.

Steady Ltd reports the following amounts to Inland Revenue in its employment information (together with Olivia's usual salary information, if applicable):

Gross earnings	$5,045.00
Employee share scheme earnings	$10,000.00
Earnings not liable for ACC earners' levy	$10,000.00
PAYE deductions	$5,045.87 ($3,300 + $1,745.87)

The additional payment of $5,045.87 that Steady Ltd makes to Olivia in its payroll system is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes. For reporting purposes, ESS earnings have their own separate field and are not included in the gross earnings field.

Example | Tauira 5 – Employer funds tax and student loan deduction

Paora receives some shares under an ESS from his employer, Steady Ltd. He does not pay anything for the shares. The value of the ESS benefit is $10,000. The terms of the scheme state that Steady Ltd will withhold tax from the ESS benefit and fund the payment of the tax and any standard student loan deduction.

Paora has a student loan and uses an SL tax code. He is not a KiwiSaver member. His annual salary is higher than the maximum liable earnings for ACC earners' levy.

Steady Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Paora of 33% ($10,000 × 33% = $3,300). It calculates the student loan deduction on the ESS benefit to be $1,200 using the standard student loan deduction rate of 12%. The total amount funded by Steady Ltd is $4,500.

Steady Ltd must gross up the amount of $4,500. This is because Steady Ltd is providing Paora with a further benefit (the tax and student loan payments) that is an "extra pay" and assessable income to Paora. As a result, further tax is payable and further student loan deductions are required. Steady Ltd calculates the gross-up as follows:

Gross income =	$4,500.00 / (1 – (0.33 + 0.12))
	$4,500.00 / (1 – 0.45)
	$4,500.00 / 0.55
	$8,181.82

Steady Ltd makes a payment of $8,181.82 to Paora in its payroll system and withholds tax of $2,700 at 33% and deducts student loan of $981.82 at 12%. The net amount of $4,500 is not paid to Paora's bank account, instead Steady Ltd makes deductions for $3,300 (tax on the ESS benefit) and $1,200 (student loan on the ESS benefit) and pays these amounts to Inland Revenue.

Steady Ltd reports the following amounts to Inland Revenue in its employment information (together with Paora's usual salary information, if applicable):

Gross earnings	$8,181.00
Employee share scheme earnings	$10,000.00
Earnings not liable for ACC earners' levy	$10,000.00
PAYE deductions	$6,000.00 ($3,300 + $2,700)
Student loan deductions	$2,181.82 ($1,200 + $981.82)

The additional payment of $8,181.82 that Steady Ltd makes to Paora in its payroll system is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes. For reporting purposes, ESS earnings have their own separate field and are not included in the gross earnings field.

Example | Tauira 6 – Employer funds tax but not student loan deduction

Quinn receives some shares under an ESS from her employer, BigCo Ltd. She does not pay anything for the shares. The value of the ESS benefit is $10,000.

The terms of the scheme state that BigCo Ltd will withhold tax from the ESS benefit and fund the payment of the tax but will not fund the payment of any student loan deduction. The employee must fund the cost of any student loan deduction on the ESS benefit and this amount will be deducted from the employee's usual net salary.

Quinn has a student loan and uses an SL tax code. She is not a KiwiSaver member. Her annual salary is $156,000 which is higher than the maximum liable earnings for ACC earners' levy.

BigCo Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Quinn of 33% ($10,000 × 33% = $3,300). The student loan deduction on the ESS benefit is $1,200 (12%).

BigCo Ltd must gross up the amount of $3,300. This is because BigCo Ltd is providing Quinn with a further benefit (the tax payment) that is an "extra pay" and assessable income to Quinn. As a result, further tax is payable. BigCo Ltd calculates the gross-up as follows:

Gross income =	$3,300.00 / (1 – 0.33)
	$3,300.00 / 0.67
	$4,925.37

BigCo Ltd makes a payment of $4,925.37 to Quinn in its payroll system and withholds tax of $1,625.37. The net amount of $3,300 is not paid to Quinn's bank account, instead Steady Ltd makes a deduction for that amount and pays it to Inland Revenue as the tax on the ESS benefit.

Quinn must fund student loan repayments on the ESS benefit of $1,200 and on the additional payment of $591.04 ($4,925.37 × 12% = $591.04). Quinn agrees in writing that Big Co Ltd should deduct these amounts from her next net salary payment. Quinn's payslip for her next fortnightly salary payment shows:

Payments	
Salary	$6,000.00
Deductions	
PAYE	$1,718.32
Student loan	$608.64
Student loan on ESS benefit and grossed-up additional payment	$1,791.04
Net amount	$1,882.00

BigCo Ltd reports the following amounts to Inland Revenue in its employment information:

Gross earnings	$10,925.00 ($4,925.37 + $6,000)
Employee share scheme earnings	$10,000.00
Earnings not liable for ACC earners' levy	$10,000.00
PAYE deductions	$6,643.69 ($3,300 + $1,625.37 + $1,718.32)
Student loan deductions	$2,399.68 ($1,200 + $591.04 + $608.64)

The additional payment of $4,925.37 that BigCo Ltd makes to Quinn in its payroll system is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes. For reporting purposes, ESS earnings have their own separate field and are not included in the gross earnings field.

Example | Tauira 7 – Employer funds tax, student loan and KiwiSaver

Shoko receives some shares under an ESS from her employer, Steady Ltd. She does not pay anything for the shares. The value of the ESS benefit is $10,000.

The terms of the scheme state that Steady Ltd will withhold tax from the ESS benefit and fund the payment of the tax and any standard student loan deduction. Steady Ltd has also agreed to fund any KiwiSaver deduction that applies.

Shoko has a student loan and uses an SL tax code. She is also a KiwiSaver member and her contribution rate is 6%. Her employer's contribution rate is 3% and the employer superannuation contribution tax (ESCT) rate is 33%. Shoko's annual salary is higher than the maximum liable earnings for ACC earners' levy.

Steady Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Shoko of 33% ($10,000 × 33% = $3,300). It calculates the student loan deduction on the ESS benefit to be $1,200 using the standard student loan deduction rate of 12%. The total amount funded by Steady Ltd is $4,500.

Steady Ltd must gross up the amount of $4,500. This is because Steady Ltd is providing Shoko with a further benefit (the tax and student loan payments) that is an "extra pay" and assessable income to Shoko. As a result, further tax is payable and further student loan deductions are required. KiwiSaver deductions (and employer contributions) also apply to the additional payment. Steady Ltd calculates the gross-up as follows:

Gross income =	$4,500.00 / (1 – (0.33 + 0.12 + 0.06))
	$4,500.00 / (1 – 0.51)
	$4,500.00 / 0.49
	$9,183.67

The gross amount is income to Shoko and is applied as follows:

Tax on ESS benefit at 33%	$3,300.00
Tax on grossed-up additional pay at 33%	$3,030.61
SL on ESS benefit at 12%	$1,200.00
SL on additional pay at 12%	$1,102.04
KS on additional pay at 6%	$551.02
	$9,183.67

None of the additional payment is paid to Shoko's bank account, instead Steady Ltd makes the deductions described in the table above and pays those amounts to Inland Revenue.

Steady Ltd is also required to make a KiwiSaver employer contribution (and withhold ESCT) on the additional payment of $9,183.67. The employer contribution is $275.51 ($9,183.67 x 3%). ESCT is $90.75 ($275 x 33%).

Steady Ltd reports the amounts in the table below in its employment information (together with Shoko's usual salary information, if applicable).

Gross earnings	$9,183.00
Employee share scheme earnings	$10,000.00
Earnings not liable for ACC earners' levy	$10,000.00
PAYE deductions	$6,330.61 ($3,300 + $3,030.61)
Student loan deductions	$2,302.04 ($1,200 + $1,102.04)
KiwiSaver employee deductions	$551.02
Net KiwiSaver employer contribution	$184.76
Employer superannuation contribution tax	$90.75

The additional payment of $9,183.67 that Steady Ltd makes to Shoko in its payroll system is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes. For reporting purposes, ESS earnings have their own separate field and are not included in the gross earnings field.

Example | Tauira 8 – Employer funds tax but not KiwiSaver

Robert receives some shares under an ESS from his employer, Cars Ltd. He does not pay anything for the shares. The value of the ESS benefit is $10,000.

The terms of the scheme state that Cars Ltd will withhold tax from the ESS benefit and fund the payment of the tax but will not fund the payment of any KiwiSaver deduction that applies. The employee must fund the cost of any KiwiSaver deduction and this amount will be deducted from the employee's usual net salary.

Robert is a KiwiSaver member and his contribution rate is 6%. His employer's contribution rate is 3% and the ESCT rate is 33%. Robert does not have a student loan. His annual salary is $156,000 which is higher than the maximum liable earnings for ACC earners' levy.

Cars Ltd calculates the tax on the ESS benefit to be $3,300 using the appropriate extra pay tax rate for Robert of 33% ($10,000 × 33% = $3,300).

Cars Ltd must gross up the amount of $3,300. This is because Cars Ltd is providing Robert with a further benefit (the tax payment) that is an "extra pay" and assessable income to Robert. As a result, further tax is payable. KiwiSaver deductions (and employer contributions) also apply to the additional payment. However, the additional payment is not required to be grossed up for KiwiSaver as Robert is funding the KiwiSaver employee deduction. Cars Ltd calculates the gross-up as follows:

Gross income =	$3,300.00 / (1 – 0.33)
	$3,300.00 / 0.67
	$4,925.37

Cars Ltd makes a payment of $4,925.37 to Robert in its payroll system and withholds tax of $1,625.37 at 33% ($4,925.37 × 33% = $1,625.37). The net amount of $3,300 is not paid to Robert's bank account, instead Steady Ltd makes a deduction for that amount and pays it to Inland Revenue as the tax on the ESS benefit.

Robert must fund the KiwiSaver deduction on the additional payment of $295.52 ($4,925.37 × 6% = $295.52). Robert agrees in writing that Cars Ltd should deduct this amount from his next net salary payment. Robert's payslip for his next fortnightly salary payment shows:

Payments	
Salary	$6,000.00
Deductions	
PAYE	$1,718.32
KiwiSaver employee contribution	$360.00
KiwiSaver employee contribution on grossed-up additional payment	$295.52
Net amount	$3,626.16

Cars Ltd is also required to make a KiwiSaver employer contribution (and withhold ESCT) on the additional payment of $4,925.37. The employer contribution is $147.76 ($4,925.37 x 3%). ESCT is $48.51 ($147 x 33%).

Cars Ltd reports the amounts in the table below in its employment information.

Gross earnings	$10,925.00 ($4,925.37 + $6,000)
Employee share scheme earnings	$10,000.00
Earnings not liable for ACC earners' levy	$10,000.00
PAYE deductions	$6,643.69 ($3,300 + $1,625.37 + $1,718.32)
KiwiSaver employee deductions	$655.52 ($295.52 + $360)
Net KiwiSaver employer contributions	$99.25
Employer superannuation contribution tax	$48.51

The additional payment of $4,925.37 that Cars Ltd makes to Robert in its payroll system is not included in the value of the ESS benefit. The value of the ESS benefit is $10,000 for tax purposes. For reporting purposes, ESS earnings have their own separate field and are not included in the gross earnings field.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Accident Compensation Act 2001, ss 6 ("earnings", "earnings as an employee"), 9, 11, 221

Income Tax Act 2007, ss CE 1, CE 2, CE 7 ("employee share scheme"), CE 7B, RA 5, RD 3, RD 7 ("extra pay"), RD 7B, RD 10, RD 17, RD 22, subpart CW, subpart CZ, sch 2, part B

KiwiSaver Act 2006, s 4 ("salary or wages")

Student Loan Scheme Act 2011, ss 4 ("salary or wages"), 36, 37

Other references | Tohutoro anō

ACC earners' levy rates **ird.govt.nz/income-tax/income-tax-for-individuals/acc-clients-and-carers/acc-earners-levy-rates**

Calculate PAYE for a lump sum payment ird.govt.nz/employing-staff/payday-filing/non-standard-filing-of-employment-information/lump-sum-payments/calculate-paye-for-a-lump-sum-payment

Correcting extra pay inaccuracy on termination **taxtechnical.ird.govt.nz/tib/volume-36---2024/tib-vol36-no4**

Employer's guide - IR335 (guide, Inland Revenue, April 2024) **ird.govt.nz/index/all-forms-and-guides#sort=relevancy&numberOfResults=25**

Filing employment information about ESS benefits **ird.govt.nz/employing-staff/paying-staff/employee-share-schemes/filing-ei-about-ess-benefit**s

IS 24/05: Employer obligations for employee share scheme benefits paid in cash

QB 23/05: Provisional tax – impact on salary or wage earners who receive a one-off amount of income without tax deducted **Tax Information Bulletin** Vol 35, No 5 (June 2023)

taxtechnical.ird.govt.nz/tib/volume-35---2023/tib-vol35-no5

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Weekly and fortnightly PAYE deduction tables – IR340 (guide, Inland Revenue 2025); **Four-weekly and monthly PAYE deduction tables – IR341** (guide, Inland Revenue 2025)
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COMMISSIONER'S STATEMENT

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

CS 24/01: Determining the "market value" of shares that an employee receives under an employee share scheme

Issued: 31 July 2024

About this document

The purpose of a Commissioner's Statement is to inform taxpayers of the Commissioner's position on a particular tax matter.

This statement provides guidance on working out the market value of a share benefit that employees receive under an employee share scheme.

This statement updates and replaces the Commissioner's Statement CS 17/01: Valuation of employee share schemes, issued on 28 April 2017, which is withdrawn from the date of issue given at the end of this statement.

The main changes relate to the legislative confirmation of the market value formula to value shares under an employee share scheme.

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

Introduction

1. This Commissioner's Statement has been updated from CS 17/01 to include the reformed rules after the introduction of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 and the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020.
2. Employers are required to determine the value of any share benefit that an employee receives under an employee share scheme (ESS) and to report this value in the relevant employment information for which the share benefit arises. Note that this value is also relevant in determining expenditure or loss for employers in relation to an ESS.
3. In addition, the rules allow employers to elect to withhold PAYE on share benefits that employees receive.
4. This statement provides taxpayers with safe harbour valuation methods that the Commissioner will accept. However, it will not apply to any arrangements that are subject to any anti-avoidance provisions in the Act.
5. This statement also provides guidance on the information the company[1] should retain to support the valuation (in addition to any constitutional and Companies Act 1993 requirements).
6. This statement is not intended to provide a definitive and comprehensive set of valuation techniques, and companies may still apply other valuation methods that determine the market value of a share. If a company does use another valuation method, the valuation must reflect the market value of the shares on the share scheme taxing date.

1 Please note that "company" refers to the employing company even if another entity issues or transfers the shares in question to the employee.

Discussion

7. An ESS is defined in s CE 7 of the Act as:
   (a) an arrangement with a purpose or effect of issuing or transferring shares in a company (company A) to a person—
      (i) who will be, is, or has been an employee of company A or of another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:
      (ii) who will be, is, or has been a shareholder-employee in relation to company A or in relation to another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:
      (iii) who is an associate of a person described in subparagraph (i) or (ii) (person A), if the arrangement is connected to person A's employment or service; but
   (b) does not include an arrangement that—
      (i) is an exempt ESS:
      (ii) requires market value consideration to be paid by a person described in paragraph (a) for the transfer of shares in the company on the share scheme taxing date:
      (iii) requires a person described in paragraph (a) to put shares, acquired by them for market value consideration, at risk, if the arrangement provides no protection against a fall in the value of the shares and none of the consideration for acquiring the shares is provided to the person under an agreement that it is used for acquiring the shares.
8. Broadly, an ESS is 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. This includes past, present and future employees. An ESS also includes where shares are provided to an associate of an employee, if this is in connection with the employee's employment or service.
9. These arrangements cover a wide range of share schemes. They may involve the immediate transfer of shares, the granting of share options, or deferred share schemes where shares vest or are transferred at a later date.
10. Section CE 2 of the Act determines the amount of the benefit the employee receives, by applying a formula on the share scheme taxing date (SSTD). It is the employee that receives this benefit under s CE 2, regardless of whether it is the employee or an associate of the employee that receives the shares.
11. Section CE 7B of the Act determines the SSTD. Where the trigger for the SSTD is that the employee (or their associate) receives shares under an ESS, the amount of the benefit under s CE 2 for the employee will be the market value of the shares on the SSTD less the amount the employee (or their associate) paid for the shares.
12. For ease of reference, the rest of this statement uses the term "ESS beneficiary" to mean persons that receive shares under an ESS (including where shares are provided to the employee's associates).

Value of share benefit

13. The amount of the benefit arising for an employee under an ESS is determined by the formula in s CE 2(1) as follows:

    share value – consideration paid + consideration received – previous income

14. The definitions in the formula are set out in s CE 2(2):
    - **share value** is the market value of shares or related rights owned by an employee share scheme beneficiary on the SSTD, if the SSTD is not triggered by a transfer or cancellation of the shares or related rights:
    - **consideration paid**, is the amount of consideration paid or payable by an employee share scheme beneficiary in relation to the transfer of the shares or related rights under the employee share scheme:
    - **consideration received**, is the amount of consideration paid or payable to an employee share scheme beneficiary in relation to a transfer or cancellation of the shares or related rights under the employee share scheme, not including relevant shares or related rights under a replacement employee share scheme:
    - **previous income**, is the total amount of income under s CE (1)(d) that the employee share scheme beneficiary has in relation to the shares or related rights before the date that is 6 months after the date of Royal assent of 29 March 2018 for the Taxation (Annual Rates, Employment and Investment Income, and Remedial Matters) Act 2018.

15. The Act defines the term "market value" in s CE 7CB[2] for the purpose of the ESS rules. It states that market value:
    (a) has the same meaning as in section YA 1 (Definitions), definition of market value, paragraphs (a) and (b); and
    (b) includes, for a share or option quoted on the official list of a recognised exchange, at the time, an amount equal to the 5-day volume weighted average price or any other method that is accepted by the Commissioner or is comparable to the 5-day volume weighted average price, for such shares or options.
16. Paragraphs (a) and (b) of the definition of "market value" in s YA 1 provide:
    (a) for a share or option quoted on the official list of a recognised exchange, at the time, means an amount equal to the middle market quotation at the time for a share or option having the same terms as the share or option to be valued, unless the quotation is not a fair reflection of the market value, having regard at the time to the matters referred to in paragraph (e) of the definition of recognised exchange:
    (b) for a share or option not quoted on the official list of a recognised exchange at the time, means the amount that a willing purchaser would pay to acquire the share or option in an arm's length acquisition at the time and that is determined using a method that—
        (i) conforms with commercially acceptable practice; and
        (ii) may, in appropriate cases, have regard to the present value at the time of the company's anticipated income or cash flows and the realisable value at the time of the company's assets; and
        (iii) results in a valuation that is fair and reasonable:

Acceptable valuation methods

17. Where the company adopts one of the methods outlined in this statement and retains the necessary documentation to support the valuation, the Commissioner will accept the market value of the share in the formula in s CE 2(1).
18. Absolute accuracy is not expected in all scenarios (as accuracy depends in part on the data sets available and in some situations on subjective judgement). However, the Commissioner expects that the company will follow a reasonable, appropriate process when determining the share value at the time the shares are issued.
19. It is also expected that the company will fully document and retain the valuation method and any input assumptions it used to prepare the valuation because the Commissioner may request to examine this documentation.
20. Where a company adopts a method not outlined in this statement, it should retain the documentation with the valuation method, any input assumptions and reasons for adopting the alternative method. Again, the reason is that the Commissioner may request to examine this documentation.
21. Which methods the Commissioner will accept will depend on whether the type of shares issued to an ESS beneficiary under an ESS are shares in:
    - a listed company;
    - an unlisted company; or
    - an unlisted start-up company.
22. For unlisted or unlisted start-up companies, discounts on the market value may be acceptable under the following circumstances:
    - Discount for lack of control arising from an inability or reduced ability for the prospective shareholder to influence the operational activities, policies and governance of the underlying company.
    - Discount for lack of liquidity to buy and sell shares arising from the absence of a readily available market.
23. This section outlines the methods the Commissioner will accept for these three types of shares.

2 Inserted by the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020.

Listed shares

24. Where the company issuing shares to an ESS beneficiary has shares listed on a "recognised exchange", the Commissioner will accept the share value reached (applicable to the class of shares, and any rights attaching to them, to which an ESS applies) using one of the following methods:
    - **Option A**: an amount equal to the 5-day volume weighted average price (VWAP) over the last 5 trading days (including the SSTD) for the listed share;[3] or
    - **Option B**: closing price of listed share on the SSTD; or
    - **Option C**: if on the SSTD an ESS beneficiary disposes of any of the shares at market value on a recognised exchange, the actual proceeds of sale for those shares on that date and, if the proceeds of sale are in a foreign currency, the New Zealand dollar equivalent by applying the close of trading spot exchange rate on the sale date.

Recognised exchange

25. A recognised exchange is defined in s YA 1 as a recognised exchange market in New Zealand or anywhere else in the world where it has the following features:
    - the exchange market brings together buyers and sellers of shares or options over shares;
    - it involves the listing of prices, whether by electronic media or other means, at which persons are willing to buy or sell shares or options; and
    - it provides a medium for determining arm's length prices likely to prove fair and reasonable, having regard to:
        - the number of participants in the market or having access to the market;
        - the frequency of trading in the market;
        - the nature of trading in the market, including how prices are determined and transactions are affected;
        - the potential or demonstrated capacity of a person or persons significantly to influence the market;
        - any significant barriers to entry to the market; and
        - any discrimination on the basis of quantity bought and sold unless based on the risks involved, the transaction costs or economies of scale.

Volume weighted average price

26. The VWAP method is set out in s CE 7CB(b). It is independent of the Commissioner's "safe harbour" (though the outcome is the same).
27. The VWAP for a share is calculated by adding up the dollars traded for every transaction relating to that share (price multiplied by number of shares traded) and then dividing by the total shares traded over the 5-day trading period (see Example | Tauira 1).

3 This method is now provided for in s CE 7CB (meaning of market value) and is not technically part of the Commissioner's "safe harbour" (though the outcome is the same, and the option has been retained here for convenience).

Example | Tauira 1: VWAP for ABC Limited over a 5-day trading period

Company ABC's shares are traded on the NZX. ABC Ltd issues shares to its employees on Friday 13 January.
Information obtained from the NZX shows the following ABC shares were traded over the previous 5 trading days (Monday 9 January to Friday 13 January):

Date	Number of shares	Volume weighted daily price
9 January	5,000	$2.00
10 January	Nil	NA
11 January	4,000	$1.98
12 January	10,000	$2.05
13 January	Nil	NA

ABC calculates the VWAP as follows:

(5,000 × $2.00) + (4,000 × $1.98) + (10,000 × $2.05) divided by 19,000 shares
= $2.02

The market value of the shares issued to ABC's employees on 13 January is $2.02.

Foreign-listed shares

28. If the shares are not listed in New Zealand but are listed on one or more overseas recognised exchanges, the foreign value determined in accordance with the above options will need to be converted to its New Zealand dollar equivalent by applying the close of trading spot exchange rate on the SSTD.
29. If the shares are listed on more than one recognised exchange (including for an employee not resident in New Zealand or a dual resident here, a recognised exchange in the employee's normal country of residence), the listed price should be based in the first instance on the recognised exchanges in the employee's country of residence. Alternatively, if that is not applicable, it should be based on the average of all the listed prices as converted to New Zealand dollars.

Newly listed company

30. Shares that a newly listed company issues to ESS beneficiaries as part of an initial public offering (IPO) should be valued using the published offer price for the IPO.
31. The published offer price is the price included in the retail offer documentation. If the company only offers the shares to non-retail investors (eg, institutional buyers, fund managers), it should use the VWAP of the investors following the relevant offer documentation.
32. If there has been no arm's length trading of the newly listed shares, the published offer price can be used for shares issued to ESS beneficiaries after the date of the IPO for a period not exceeding 6 months (unless the assumptions used to calculate the offer price change materially).

Information requirements

33. The company should retain information that can support the share value and method and should be able to supply the relevant documentation to the Commissioner on request. It should retain one of the following categories of information, based on its individual circumstances:
    - if it uses Option A, VWAP calculation and supporting listed price data;
    - if it uses Option B, closing market listed price data;
    - if it uses Option C, documents evidencing the sale and currency conversion and, where an independent third party undertakes the sale and any subsequent conversion of the proceeds to New Zealand dollars, that third party's advice of the New Zealand dollar equivalent of the transaction;
    - if newly listed shares, the published offer price; or
    - if foreign-listed shares, the relevant published offer price or listed price data and the spot FX rate used.

Unlisted shares

34. Where the company issuing shares to an ESS beneficiary has unlisted shares (excluding a start-up company, which is defined for the purposes of this guidance at [45]), the principles in para (b) of the definition of "market value" in s YA 1 (as set out at [16]) will apply. This requires finding the amount that a willing but not anxious purchaser would pay to acquire the share or option in an arm's length acquisition at the time using methods set out in para (b) of the "market value" definition in s YA 1.
35. Taking those considerations into account, the Commissioner will accept the share value reached (applicable to the class of shares, and any rights attaching to them, to which an ESS applies) using one of the following methods:
    - **Option A**: an arm's length value determined by an independent, suitably qualified valuer that conforms with commercially accepted practice;[4]
    - **Option B**: a valuation involving the arm's length issue or sale of the same class of shares to a non-associated third party in the 6 months prior to the SSTD (eg, a previous capital raising or sale of a parcel of shares) where, if new shares are being issued to ESS beneficiaries, the valuation is adjusted for dilution of existing shares; or
    - **Option C**: a valuation that an appropriate person in the company prepares using an appropriate method (see [44] for an explanation of this option and the requirements for using it).

Dilution effect when issuing new shares

36. All methods of valuation should consider the diluting effect of issuing new shares to ESS beneficiaries, as Example | Tauira 2 illustrates.

Example | Tauira 2: Dilution effect of issuing new shares

Company A has previously issued 1 million shares to non-associated third parties for $1 million. Subsequently, Company A issues 100,000 new shares to employees for no consideration. The value of the shares will be calculated as follows:

Total consideration paid for shares issued $1 million divided by total shares issued 1.1 million

= $0.91 per share.

4 For the purposes of [41] and [51], "commercially accepted practice" means a valuation prepared under Advisory Engagement Standard 2: Independent Business Valuation Engagements issued by Chartered Accountants Australia and New Zealand, or an equivalent valuation engagement standard.

Foreign company

37. If a company holds its unlisted shares in a foreign company, it will need to convert the foreign value determined in accordance with the options set out at [35] to its New Zealand dollar equivalent by applying the close of trading spot exchange rate on the SSTD.

Previous valuation

38. The Commissioner will accept a value based on the most recent valuation prepared by a company using Option A, B or C if the valuation:
    - is for the same class of shares as the shares issued to the employee; and
    - was prepared within a period not exceeding 6 months prior to the SSTD.
39. This statement will not apply where a company uses a previous valuation and the original share value is adjusted, resulting in a lower value (discounting). This statement will also not apply where the previous valuation relates to shares of a different class from the shares issued under the ESS.

Information requirements

40. The company should retain information that can support the share value and method and should be able to supply the relevant documentation to the Commissioner on request. The information that the company should retain depends on which option it uses, as outlined in the following paragraphs.
41. If the company uses Option A, it should retain a copy of the independent valuation report it received.
42. If the company uses Option B, it should retain:
    - documentation supporting the value of the shares issued or sold to the non-associated third party (eg, a copy of sale and purchase agreement or capital raising documentation);
    - confirmation that the shares are of the same class; and
    - written approval of the valuation by one member of the board of directors or the chief financial officer or the chief executive officer of the company, confirming that in their opinion the valuation reflects the market value of the shares issued to the ESS beneficiary at the SSTD.
43. If the company uses Option C, the information requirements are more detailed, as outlined at [44].

Option C: Information requirements for an internally prepared valuation

44. The company should provide a copy of the internally prepared valuation along with:
    - confirmation that the person who prepared the valuation was employed by the company and has the necessary financial skills, qualification and experience to prepare a valuation;
    - confirmation that the valuation is based on an appropriate method. The Commissioner considers either of the following methods is appropriate:
        - discounted cash flow (DCF); or
        - capitalisation of earnings;
    - contemporaneous documentation supporting all workings, input assumptions and comparable data used to prepare the valuation. This should include the following information (where applicable):
        - financial information used to determine earnings (for capitalisation of earnings method) or future cash flows (for DCF method), including (but not limited to): prior year financial statements; current operating results; and cash flows and future-oriented financial information such as budgets, forecasts and projections;
        - documentation supporting any normalising adjustments;
        - documentation supporting discount rates;
        - documentation supporting capitalisation rates or earnings multiples (including any comparable data used to determine earnings multiples); and
        - reasoning and support for any discounts or premiums;

- written approval of the valuation by one member of the board of directors or the chief financial officer or the chief executive officer of the company, confirming that in their opinion the valuation reflects the market value of the shares issued to the ESS beneficiary on the SSTD or, alternatively, confirmation that an independent, suitably qualified valuer, who was appointed or instructed by the board of directors, has reviewed and agreed with the valuation; and
- a copy of the independent valuation opinion (if applicable).

Shares in an unlisted start-up company

45. The company issuing shares to an ESS beneficiary can apply the approach outlined in this section where it is a start-up company. Being a start-up company generally means that the company:
    - is in the first stage of its operations;
    - is initially financed and operated by founding shareholders or investors;
    - has not paid any dividends;
    - has expenses that tend to exceed its revenues and may not yet be producing a profit;
    - tends to have very low net tangible assets;
    - may have a high level of expended research and development costs relative to its tangible assets value; and
    - does not yet have a stable market for its product or service.
46. The Commissioner will accept one of the following methods for valuing start-up company shares:
    - **Option A**: an arm's length value determined by an independent, suitably qualified valuer that conforms with commercially accepted practice;
    - **Option B**: a valuation involving the arm's length share issue or sale of the same class of shares to a non-associated third party in the 12 months prior to the SSTD (eg, a previous capital raising or sale of a parcel of shares) where, if new shares are being issued to ESS beneficiaries, the valuation is adjusted for dilution of existing shares; or
    - **Option C**: a valuation that an appropriate person in the company prepares using an appropriate method (see [44] for an explanation of this option and the requirements for using it). Option C will not be available if the company has a previous valuation under Option A or a recent issue or sale of shares under Option B.

Venture capital funding

47. Given share valuations for venture capital funding rounds are complex, this statement does not apply to a company with a venture capital funding round[5] that is either current or proposed (ie, is intended to take place within 6 months of the SSTD for the ESS beneficiary). The company should obtain a separate arm's length valuation for any shares issued to ESS beneficiaries under an ESS where venture capital funding is involved.

Previous valuation

48. The Commissioner will accept a value based on the most recent valuation that a company has prepared using Option A, B or C if the valuation:
    - is for the same class of shares as the shares issued to the ESS beneficiary; and
    - was prepared within a period not exceeding 12 months prior to the SSTD for the ESS beneficiary.
49. This statement will not apply where a company uses a previous valuation and the original share value is adjusted, resulting in a lower value. This statement will also not apply where the previous valuation relates to shares of a different class from the shares issued under the ESS.

Information requirements

50. The company should retain information that can support the share value and method and be able to supply the relevant documentation to the Commissioner on request. The information the company should retain depends on which option it uses, as outlined in the following paragraphs.
51. If the company uses Option A, it should retain a copy of the independent valuation report it received.

5 A venture capital funding round means funding by a venture capital fund or firm (including Series A funding rounds). It does not include seed funding from private investors.

52. If the company uses Option B, it should retain:
    - documentation supporting the value of the shares issued or sold to the non-associated third party (eg, copy of sale and purchase agreement or capital raising documentation);
    - confirmation that the shares sold to the non-associated third party are of the same class as the ESS shares and have the same rights attached to them; and
    - written approval of the valuation by one member of the board of directors or the chief financial officer or the chief executive officer of the company confirming that in their opinion the valuation reflects the market value of the shares issued to the ESS beneficiary at the SSTD.
53. If the company uses Option C, the information requirements are more detailed, as outlined at [44].

Option C: Information required for an internally prepared valuation

54. If the company has prepared a valuation internally, it should retain:
    - a copy of the internally prepared valuation;
    - confirmation that the person who prepared the valuation was employed by the company and has the necessary financial skills, qualification and experience to prepare a valuation;
    - confirmation that the valuation is based on an appropriate method. The Commissioner considers the appropriate method is the DCF;
    - contemporaneous documentation supporting all workings, input assumptions and comparable data used to prepare the valuation. This should include the following information (where applicable):
        - financial information used to determine future cash flows including (but not limited to): prior year financial statements; current operating results; and cash flows and future-oriented financial information such as budgets, forecasts and projections;
        - documentation supporting any normalising adjustments;
        - documentation supporting discount rates;
        - documentation supporting capitalisation rates; and
        - reasoning and support for any discounts or premiums;
    - written approval of the valuation by one member of the board of directors or the chief financial officer or the chief executive officer of the company, confirming that in their opinion the valuation reflects the market value of the shares issued to the ESS beneficiary on the SSTD or, alternatively, confirmation that an independent, suitably qualified valuer, who was appointed or instructed by the board of directors, has reviewed and agreed with the valuation; and
    - a copy of the independent valuation opinion (if applicable).

Application

55. This statement along with its predecessor (CS 17/01) provide general guidance on working out the market value of a share benefit that employees receive under an ESS as outlined in the Act. The Commissioner will apply the position in the statements to shares ESS beneficiaries acquire on or after 1 April 2017.[6]
56. If you have any concerns about your compliance with the tax obligations discussed in this statement, you should discuss them with an appropriately qualified tax professional.

Matthew Evans
Technical Lead,
Legal Services (Technical Standards)

Date of Issue: 31 July 2024

6 This date reflects the Commissioner's safe harbour that applied before the 2018 legislative amendment to define "market value" in s CE 7B of the Act.

STANDARD PRACTICE STATEMENTS

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

SPS 24/01: Requests to change a balance date

Issued: 30 July 2024

A standard practice statement (SPS) describes how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

This SPS explains how to apply for a change of balance date and how the Commissioner will use their discretion under s 38 of the Tax Administration Act 1994 to approve a change of balance date.

START DATE 30 July 2024

REPLACES

- **SPS 18/02**: Requests to change a balance date

Introduction

This standard practice statement (SPS) sets out the Commissioner's practice for considering and approving requests to change a balance date for income tax purposes. The expression "non-standard balance date" in this SPS refers to a balance date other than 31 March.

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

Application

This SPS applies from 30 July 2024. It replaces **SPS 18/02**: Requests to change a balance date.

Standard practice

Summary

1. Section 38 allows the Commissioner to agree to a customer filing an income tax return for the year ending on the balance date of the customer's annual accounts when it is not a standard 31 March balance date.
2. Only customers with an obligation to file returns under s 33 may apply under s 38 to adopt a balance date other than 31 March. Individuals only earning "reportable income" and certain multi-rate portfolio investment entities (multi-rate PIEs) cannot request a change of balance date (see further at [8]).
3. The Commissioner has an obligation to protect the integrity of the tax system, including applying the tax laws fairly, impartially and according to the law. Every request to change a balance date will be considered on its individual merit in line with this SPS.
4. Subject to the detailed discussion in this SPS, approval will be provided where the Commissioner is satisfied the change is not for reasons as outlined at [16].

Detailed discussion

Overview of the authority to change a balance date

5. Customers wishing to change their balance date must obtain the Commissioner's agreement, under s 38, before they can file a return for that new balance date (this includes elections by new business customers to adopt a non-standard balance date, with application from their first return/tax year). This applies to customers wishing to:
   a) adopt a non-standard balance date;
   b) change from a non-standard balance date back to 31 March; or
   c) change from one non-standard balance date to another non-standard balance date.
6. Section 38 states the following:

> **38 Returns to annual balance date**
>
> (1) Instead of furnishing a tax year return under section 33 on the basis of a corresponding income year that ends on 31 March, a taxpayer may, with the consent of the Commissioner, elect to furnish a return based on a corresponding income year that ends with the date of the annual balance of the taxpayer's accounts.
>
> (1B) A multi-rate PIE that does not calculate and pay tax using the provisional tax calculation option under section HM 44 of the Income Tax Act 2007 must not make an election under subsection (1).
>
> (1C) Subsection (1) does not apply to a qualifying individual whose final account for the tax year is treated under section 22I(1)(b) as an assessment.
>
> *(2) [Repealed]*
>
> (3) Any election made by a taxpayer for the purposes of this section shall continue in force unless and until it is altered by the taxpayer with the prior notified approval of the Commissioner.

7. A 31 March balance date is the default for a "tax year" in s 33, and s YA 1 of the Income Tax Act 2007 (ITA) defines "tax year" as a period starting 1 April and ending 31 March. However, s 38(1) lets the Commissioner approve the filing of tax returns for an income year that does not end on 31 March.
8. Individuals only earning "reportable income" (types of income where tax has been withheld at source by the payer, such as a salary or wages) cannot request a change of balance date (see s 38(1C)). Multi-rate PIEs also cannot request a change of balance date unless they calculate and pay tax using the provisional tax calculation option in s HM 44 of the ITA (see s 38(1B)). The legislation provides no further guidance on how the Commissioner is to apply the discretion in s 38.
9. Non-standard balance dates between 1 October and the following 30 March (inclusive) are "early balance dates" (see s YE 1(6) of the ITA). Non-standard balance dates between 1 April and 30 September (inclusive) are "late balance dates" (see s YE 1(7) of the ITA). The income year of a non-standard balance date customer will correspond to the nearest tax year (see s YA 1 of the ITA, "corresponding income year"). For early balance date customers, an income year will correspond to the tax year ending on the following 31 March. For late balance date customers, an income year will correspond to the tax year ending on the preceding 31 March.

When the Commissioner will agree to a change in balance date

10. Subject to the detailed discussion in this SPS, the Commissioner will approve a change in balance date when satisfied the change is not for reasons outlined at [16] and that a customer can provide a correct return of income for a tax year ending on the balance date.
11. The Commissioner acknowledges there are situations where a balance date of 31 March may be impractical. The list of situations below is not exhaustive and there may be other circumstances (not contemplated in this SPS) where it would be appropriate to agree to a change to a balance date.
12. The Commissioner will agree to a change to a balance date in the following thirteen situations:
    a) The Commissioner will allow a customer to adopt an alternative balance date when the customer can demonstrate the nature of their business makes a 31 March balance date impractical or their circumstances have changed significantly and they should be permitted to change a non-standard balance date previously agreed to. For example, a 31 March balance date may be impractical for a business servicing an industry with an agreed industry balance date (see further at [28] to [33]).
    b) The Commissioner will allow a customer to adopt a non-standard balance date when they can demonstrate unreasonable or excessive compliance costs will be incurred as a consequence of having to return income to 31 March

(see further at [19] and [20]). This may include the impact of other statutory reporting requirements, such as where a customer is subject to a financial year other than 31 March due to another enactment. In addition, see [21] for discussion on Māori customers and businesses adopting a 30 June balance date to align with Maramataka Māori.

c) The Commissioner will allow a customer to adopt an agreed industry balance date (see further at [28] to [33]).

d) The Commissioner will agree to a change in balance date for a franchisee who is required as a condition of a franchise agreement to use a non-standard balance date for financial reporting purposes, where the applicable balance date has been recognised in an agreement between the Commissioner and the master franchisor.

e) The Commissioner will allow a shareholder–employee to use the same balance date as the company from which they derive their primary source of income.

f) The Commissioner will allow a customer who receives passive income, so has an obligation to provide a return of income to 31 March for that passive income as well as any business income they earn, to adopt a non-standard balance date for returning their business income. If the business income has a source in a related business entity, a customer may elect to return income to the balance date of that related entity (see further at [22] to [25]).

g) The Commissioner will allow a subsidiary company to use the same balance date as the parent company.

h) The Commissioner will allow a common balance date for business entities with a close working relationship. This is where they share a common business or management accounting system or central administration structure and one entity has an approved non-standard balance date. This category includes a joint venture that has chosen to be treated as a partnership for income tax purposes (so will file partnership income tax returns) wanting to adopt a balance date in common with a joint venturer.

i) The Commissioner will allow a managed fund to adopt a balance date in common with a fund manager or trustee when it can be demonstrated that the parties have a parent–subsidiary-like relationship (see further at [34]).

j) The Commissioner will agree to a change in balance date for entities deemed to be agents of non-resident insurers that are required to file as-agent returns in terms of s HD 16 of the ITA (see further at [34]).

k) The Commissioner will allow a non-resident to adopt a balance date applicable to the customer's tax jurisdiction, when they perform business activities in New Zealand but have a centre of management outside New Zealand (this does not apply to non-residents that merely earn passive investment income in New Zealand).

l) The Commissioner will allow an executor or administrator of an estate to adopt the date that coincides with the date of death of the deceased customer as the balance date for the continuing estate.

m) The Commissioner will allow a previously tax-exempt entity to continue to use a balance date consistent with an existing date for financial reporting purposes. For example, a charity that previously had only exempt income, so was not required to file tax returns, but is now required to file returns, may continue to use the non-standard balance date they had used before entering the tax base.

13. When agreeing to a change in balance date, the Commissioner will only agree to an annual balance date that is the last calendar day of a month rather than part-way through a month.

14. An exception to the end of the month rule exists for an executor or administrator of a continuing estate that elects to adopt a balance date that coincides with a deceased customer's date of death.

15. Where the Commissioner has already agreed to a balance date other than the last calendar day of a month, these agreements will not be revisited unless a further request to change a balance date is received. Similarly, in these situations, subsidiary entities are permitted to adopt the non-standard balance date of a parent entity.

When the Commissioner will not agree to a change in balance date

16. The Commissioner will not agree to a change in balance date when:

a) a reason for the change is to defer the payment of tax or to take earlier advantage of a tax incentive or concession than would otherwise have been the case had no change of balance date occurred;

b) the request has been made because the customer wants to smooth out administrative workloads in its business (this does not include seasonal businesses wanting to adopt a balance date that is consistent with the natural end of their income year);

c) the non-standard balance date is the anniversary date of the commencement of the business unless that date coincides with an agreed industry balance date;

d) the request is made to smooth the workflow of a manager, trustee or tax agent;

e) the customer has investment income and no direct involvement in a business activity (see further at [22] to [25]); and

f) functions have been contracted out to a third party, such as a specialist administration manager, and the customer wishes to adopt the manager's balance date.

Consideration of requests

17. In considering a request to change a balance date, the Commissioner will look at relevant matters, consistent with their statutory responsibilities under s 6 to maintain the integrity of the tax system.

18. The Commissioner will consider supporting information in a request to change a balance date. The Commissioner may also consider other relevant information held for a customer and wider industry practice when establishing their view about whether the circumstances of a particular case provide sufficient cause for the customer not to return income to their current balance date. The following paragraphs explain the matters the Commissioner will consider.

Compliance costs

19. Business customers may incur compliance costs in several ways, including to meet general accounting, financial and reporting requirements. Compliance costs will be considered when a customer can show they will incur unreasonable or excessive costs as a consequence of having to return income to 31 March (or their current balance date). The Commissioner will consider normal compliance costs, excluding, for instance, costs customers incur by choice through self-imposed internal planning or reporting requirements.

20. The Commissioner will also consider the impact of other statutory reporting requirements on customers' annual accounts (such as where a customer is subject to a financial year other than 31 March due to another enactment) and their tax obligation to return income.

21. In addition, Example 1 below illustrates a situation where the Commissioner agrees to Māori businesses changing their balance date to 30 June to align with Maramataka Māori (the Māori lunar calendar). 30 June is the balance date closest to the start of Maramataka Māori. Allowing Māori customers and businesses to adopt a 30 June balance date to align with Maramataka Māori recognises that some Māori customers and businesses have financial planning, cashflow, and accounts aligned with Maramataka Māori.

Example 1: 30 June balance date to align with Maramataka Māori

Six related Māori businesses (a company established as a result of a Tiriti o Waitangi | Treaty of Waitangi settlement, a charity, three Māori authorities and an associated company) request a change of balance date to 30 June to align with Maramataka Māori.

Aligning with Maramataka Māori, the businesses use a 30 June date for financial reporting purposes and their cashflow and funding arrangements are also based around a 30 June cycle. The businesses also work closely with other businesses that have a 30 June balance date.

The Commissioner agrees to each of the six businesses adopting a 30 June balance date.

Passive income

22. Passive income is income derived from investments or property that does not require direct physical exertion or the application of specialist skill by a customer (for example, the receipt of interest or dividends). This can be contrasted with income derived from a business activity. A business includes a profession, trade or undertaking carried on for profit.

23. Customers whose primary source of income is from passive investments will generally be required to return income to 31 March. Much of the information on earnings required to file a return is available from financial institutions on a periodic basis.

24. An exception to this general rule is when entities related to a customer are engaged in a business activity that has a non-standard balance date. This exception is to avoid additional compliance costs and disruption with preparing annual accounts when a customer derives passive income through the business activity of a related entity.

25. Example 2 illustrates how the passive income exception may arise.

Example 2: Passive income from a related entity

Trust and partnership

The trustees of a family trust (the family trust) lease a farm to a family trading partnership. The family trust passively derives its primary source of income from lease payments made by the related family partnership, which has a non-standard balance date.

The Commissioner agrees to the family trust adopting the non-standard balance date the partnership uses.

Variation: trust and company

Instead of a partnership, the family trust leases the farm to a farming company in which it is the majority shareholder. In addition to income from lease payments, the family trust also derives dividend and interest income from the farming company, which has a non-standard balance date.

The Commissioner agrees to the family trust adopting the non-standard balance date the farming company uses. The family trust returns income from the lease, the dividend income and the interest income to this non-standard balance date.

Income from a foreign investment fund

26. Customers with an attributing interest in a foreign investment fund (FIF) that calculate their FIF income or loss using the attributable FIF income method may change the accounting year used to calculate this income or loss in accordance with specific rules in s EX 69 of the ITA. The Commissioner's agreement is required before the customer can use a new balance date.

Customers with salary or wages as well as business income

27. Where a customer has income from salary or wages as well as business income, the Commissioner may still agree to a non-standard balance date for the business income. The customer's salary or wage income would continue to be returned to 31 March.[1] This is illustrated in Example 3.

Example 3: Salary or wages as well as business income

A customer earns a salary as a teacher and derives business income from a small orchard. The customer wishes to adopt a non-standard balance date of 30 June.

The Commissioner agrees to the change of balance date as it is an industry-approved balance date, despite the income from the customer's salary. In her income tax return, the customer will include income from her business calculated to 30 June and income from her salary calculated to 31 March.

Industry balance dates

28. Some businesses have a natural end to their income year (for example, the end of a growing season, end of a traditionally busy trading period, or time in the annual business cycle in which most income and relevant costs can be brought to account).

29. Examples of businesses that have "natural" income years not ending on 31 March include farming and the growing or harvesting of primary produce that is subject to seasonal climate conditions or the natural cycle of stock breeding. Other businesses that may be included are directly related service industries involved in, for instance, the harvesting, processing, packaging and exporting of produce.

30. Market demands for manufactured goods and the seasonal impacts on the growing or harvesting of produce influence the trading patterns of many businesses. Customers affected by seasonal constraints or demands on their businesses may find a 31 March balance date impractical when their attention is on those seasonal activities and most of their income is yet to be derived.

1 See *Case K41* (1988) 10 NZTC 348 (TRA).

31. The natural end to a season for growers or retail manufacturers can be identified with the end of their production cycle when the last or most of their produce is delivered to a processor or retail outlet. Once the harvest or peak business period is completed, a grower or manufacturer then prepares for the next annual busy season.
32. The Commissioner recognises several industry-specific non-standard balance dates (see the Appendix). These dates were determined following industry representations to the Commissioner. Customers in these industries may apply to the Commissioner for agreement to adopt these approved industry balance dates.
33. Customers aligned to an industry with a recognised non-standard balance date may still seek an alternative non-standard balance date (or remain with 31 March) if the industry balance date does not suit their circumstances.

Unit trusts, managed funds and as-agent returns for non-resident insurers

34. The Commissioner will consider requests for a non-standard balance date from the following entities:
    a) **The trustee of a unit trust that wishes to align its balance date with that of its manager.**

       A unit trust may choose to align its balance date with that of its manager. The manager is the entity responsible for managing the unit trust and is appointed under the trust deed. Adoption of the manager's balance date is appropriate only if the manager has retained the responsibility for day-to-day administration of the unit trust.
    b) **The trustee of a group investment fund that wishes to align its balance date with that of its manager.**

       A group investment fund is administered and overseen by a manager. The fund may have a separate trustee, although there is no requirement that the trustee and manager be separate entities. Agreement will be granted only to align the fund's balance date with that of the manager.

       As with unit trusts, adoption of the manager's balance date is only appropriate when the manager has retained the responsibility for day-to-day administration of the fund and preparing the fund's accounts. When these functions have been contracted out to a third party, it is not appropriate to adopt the manager's balance date.
    c) **A superannuation fund that wishes to align its balance date with that of its trustee.**

       The trust deed under which a superannuation fund is established will appoint a trustee to supervise the fund. Agreement will be given for a fund to align its balance date with that of the trustee, provided the trustee's role has not been contracted out to a third party.
    d) **A superannuation fund administered by an employer for the benefit of its employees that wishes to align its balance date with the balance date of the employer.**
    e) **A managed fund that wants to align its tax balance date for financial reporting purposes.**

       A managed fund (including a unit trust, group investment fund or superannuation fund) may choose to align its balance date with that used for financial reporting purposes if it can demonstrate the alignment of balance dates helps reduce the managed fund's tax risks. The purpose of this is to promote voluntary compliance and good tax practices. The Commissioner expects the managed fund to set out the reasons for changing its balance date and will examine these reasons on a case-by-case basis.

       A change of balance date will not be approved if the:

       - reason for changing the balance date is to improve the managed fund's administration of human resources (for example, smoothing the workflows of their managers);
       - managed fund cannot provide evidence of the tax risks and how the change of balance date mitigates those risks; or
       - managed fund can identify some of its tax risks but the change of balance date is irrelevant to mitigating those risks.
    f) **A customer (who is a resident for taxation purposes) required to file an as-agent return and wishes to align the balance date of that return with their own non-standard balance date.**

       A customer who insures with a non-resident insurer must return part of the premiums paid as income in a return known as an as-agent return (s HD 16 of the ITA). This income is returned by the customer as-agent for the non-resident insurer.

       Customers with an approved non-standard balance date for their own returns can align the balance dates of their as-agent returns to this date.

How to make a request

35. Tables 1 and 2 below set out how different types of requests for the Commissioner's agreement to change a balance date can be made and information the request should include.

36. Where a request is made for one of the reasons included in Table 1, it can be made using myIR secure online services, by telephone (0800 377 774), or by correspondence. This is because the criteria for adopting a non-standard balance date may be easily verified at the time of contact with an Inland Revenue officer. The request reasons included in Table 2 are potentially more complex so should be made using myIR secure online services or by correspondence.

Table 1: Requests that can be made using myIR or by telephone or correspondence

<table>
<tr><th>Request reason</th><th>Information required (as relevant)</th></tr>
<tr><td>Business wanting a recognised industry balance date (see the Appendix)</td><td rowspan="7">• Full name of customer seeking the change of balance date
• Customer's IRD number (if already registered)
• Balance date sought
• Reasons for election to change balance date
• Income year the new balance date is to apply from
• Name of customer's tax agent
• Related entity's name, IRD number and nature of relationship with the customer (where customer wants to adopt a balance date in common with a related entity)
• Details of financial reporting obligations and balance date used for these obligations (where customer has financial reporting obligations to a balance date set by the Financial Reporting Act 2013 (FRA), see [67] to [76] for further information)</td></tr>
<tr><td>Shareholder–employee wanting the same non-standard balance date as a company to which their shareholding relates, where earnings from the company are their primary source of income</td></tr>
<tr><td>Continuing estate wanting a balance date coinciding with deceased customer's date of death</td></tr>
<tr><td>Subsidiary company wanting to align balance date with a parent company</td></tr>
<tr><td>Non-resident wanting a balance date applicable in their country of residence, where they perform business activity in New Zealand but have a centre of management outside New Zealand (this does not apply to customers only earning passive investment income)</td></tr>
<tr><td>Previously tax-exempt entity wanting to continue to use a balance date consistent with that used for financial reporting purposes</td></tr>
<tr><td>Māori customer or business wanting a 30 June balance date to align with Maramataka Māori, where financial planning, cashflow, and accounts are aligned with this date</td></tr>
</table>

Table 2: Requests that must be made using myIR or by correspondence

<table>
<tr><th>Request reason</th><th>Information required (as relevant)</th></tr>
<tr><td>Customer wanting a non-standard balance date due to the specific circumstances of their business activity</td><td rowspan="6">Full name of customer seeking the change of balance date
Customer’s IRD number (if already registered)
Balance date sought
Reasons for election to change balance date
Income year the new balance date is to apply from
Name of customer’s tax agent
Details of cash flows
Details of stock patterns
Details of any significant business transactions that will affect the customer’s tax liability for the current financial year
Other evidence to show financial information prepared to requested balance date will be more appropriate for the customer
Where businesses claim they have a close working relationship and share a common accounting system or central administration structure, evidence to support this assertion
Related entity’s name, IRD number and nature of relationship with the customer (where customer wants to adopt a balance date in common with a related entity)
Details of financial reporting obligations and balance date used for these obligations (where customer has financial reporting obligations to a balance date set by the FRA, see [67] to [76] for further information)</td></tr>
<tr><td>Customer wanting to change balance date as their circumstances have changed significantly and a balance date previously agreed to is no longer appropriate</td></tr>
<tr><td>Customer wanting to align balance dates for business entities with a close working relationship, where entities share a common business or management accounting system or central administration structure</td></tr>
<tr><td>Managed fund wanting to adopt the non-standard balance date of the fund manager or trustee and it can be demonstrated a parent–subsidiary-like relationship exists between parties</td></tr>
<tr><td>Entity deemed to be agent of non-resident insurer filing as-agent returns in terms of s HD 16 of the ITA</td></tr>
<tr><td>Franchise owner wanting to adopt the balance date used by a master franchisor</td></tr>
</table>

Related matters

Retrospective elections

37. Requests to change a balance date should be made before the start of a new income year, so customers can avoid additional compliance costs if the Commissioner does not approve the change of balance date.

38. The Commissioner, in limited circumstances, may agree to a retrospective change in balance date for a current income year where the request is received before the earlier of the return filing date under s 37 for the current balance date and that for the proposed balance date.

39. The Commissioner will provide retrospective agreement where customers can show:

    a) it is possible to file returns for all the income years;

    b) the late election was not made for reasons of tax deferral or tax avoidance or to take undue advantage of any tax incentive or concession; and

    c) any tax deferral occurring as a consequence of the proposed balance date change is insignificant (when compared with the customer’s total tax liability).

Misleading information

40. When a request for a change of balance date is received, the Commissioner will consider the reasons and information provided in support of the request. The onus is on customers to fully disclose the reasons for the change and provide all relevant information to support their application.

41. The Commissioner is not bound by any agreement based on misleading or incomplete information.

Notification of the Commissioner’s agreement

42. The Commissioner will generally respond to a request (by telephone, myIR secure online services or correspondence) in the same way in which the customer made their request. Where a request is approved the Commissioner will also provide written confirmation of this approval and the income tax transitional return period via myIR secure online services.

Reviewing a decision of the Commissioner

43. Section 138E(1)(e)(iv) provides there is no statutory right of challenge where the Commissioner has decided to decline a balance date change request under s 38.

44. However, if a customer is concerned their circumstances have not been given proper consideration, they should raise their concern with the officer they have been dealing with and ask that the decision be reconsidered. Customers who do this and are still not satisfied with the level of service they receive can contact Inland Revenue's Complaints Management Service. For information about how to make a complaint, see **Complaints guide – IR 1169**.

45. Following this, if a customer is still not satisfied with the decision, they may ask to have the decision reviewed by the Office of the Ombudsman or judicially reviewed. A customer wishing to apply for judicial review is strongly recommended to obtain independent legal advice.

Consequential impact of a balance date change

Income tax transitional period returns

46. This section of the SPS explains how the Commissioner applies the legislation concerning the transitional income tax returns required following the Commissioner's agreement to use an alternative balance date. It also states the Commissioner's practice on the effective date for a change of balance date.

47. Section 39 sets out the treatment for transitional year returns:

> **39 Consequential adjustments on change in balance date**
>
> (1) If the Commissioner approves a change to a new balance date that is earlier in the calendar year than the original balance date, the change is effected by the taxpayer having a transitional year of the period from the original balance date up to and including the new balance date in the next succeeding calendar year.
>
> (2) If the Commissioner approves a change to a new balance date that is later in the calendar year than the original balance date, the change is effected by the taxpayer having a transitional year of the period from the original balance date up to and including the new balance date in the same calendar year.
>
> (3) If the change in balance date means that a taxpayer has 2 corresponding income years for the same tax year, the figures for both corresponding income years are aggregated when the taxpayer's net income or net loss is determined.
>
> …

48. **Note:** Section 39 uses the terms "earlier" and "later". These should not be confused with the terms "early balance date" and "late balance date". Section 39 refers to a balance date that is "earlier in the calendar year than the original balance date" and a new balance date that is "later in the calendar year than the original balance date". The "original balance date" may itself be a non-standard balance date.

49. When the new balance date is earlier in the calendar year than the original balance date, the customer's transitional year runs from the original balance date to the new balance date in the following year.

50. When the new balance date is later in the calendar year than the original balance date, the customer's transitional year runs from the original balance date to the new balance date in the same year.

51. Under s 39, when a balance date changes, the customer must file a transitional tax return for the income derived during the transitional return period. The transitional return period will generally be between six months and 18 months long (see [54] for discussion of exceptions to this). Transitional return periods of more than a year occur where a change in balance date results in two income years that correspond to the same tax year and the customer is required to file a single return including income for both income years (see s 39(3)). Application of the transitional return rules are illustrated in Examples 4 and 5 below.

52. It is the Commissioner's view that new business customers, who may elect to apply a non-standard balance date on registration or their first return period, are not directly affected by the transitional return provisions. Their first return will cover the period from commencement of business to their elected balance date (instead of to 31 March).

53. Although the transitional year provisions are not applied directly to new customer situations, there may be occasions when a balance date election spans more than one return period by days or weeks due to the timing of a request and the Commissioner agreeing to the change. When these situations occur, favourable consideration will be given to customer requests to include the start-up income details for the initial start-up in the substantive return that follows.

Example 4: Early balance date

A customer changes from a 31 March balance date to a 31 January balance date.

The return for the 2023/24 tax year will cover the period from 1 April 2023 to 31 January 2024 (a 10-month transitional return period). The return for the 2024/25 tax year will be from 1 February 2024 to 31 January 2025.

Example 5: Late balance date

A customer changes from a 31 March balance date to a 30 June balance date.

The return for the 2023/24 tax year will cover the period from 1 April 2023 to 30 June 2024 (a 15-month transitional return period). A 15-month transitional return period occurs because 1 April 2023 to 31 March 2024 and 1 April 2024 to 30 June 2024 both correspond to the 2023/24 tax year, so the periods must be combined.

The return for the 2024/25 tax year will be from 1 July 2024 to 30 June 2025.

Returns for less than six months or more than 18 months

54. Changes to balance dates will generally result in a transitional return period of more than six months, but no longer than 18 months. However, in some circumstances, returns are required for a period of less than six months or more than 18 months. Returns for a period longer than 18 months occur only when an early balance date changes to a late balance date. Returns for a period shorter than six months occur only when a late balance date changes to an early balance date. This is illustrated in Examples 6 and 7.

Example 6: Change from a late balance date to an early balance date

In 2023, a customer changes from a balance date of 30 September to 30 November for the 2023/24 tax year. This means:

- 1 October 2022 to 30 September 2023 corresponds to the 2022/23 tax year;
- 1 October 2023 to 30 November 2023 is a two-month period in the 2023/24 tax year; and
- 1 December 2023 to 30 November 2024 corresponds to the 2024/25 tax year.

It is not possible to include the income derived during the two-month period in the 2023/24 tax year with other income derived in the same tax year, because no other income is derived during the 2023/24 tax year. The customer must file a two-month transitional return for the 2023/24 tax year.

Example 7: Change from an early balance date to a late balance date

In 2022, a customer changes from a balance date of 30 November to 31 July for the 2023/24 tax year. This means:

- 1 December 2021 to 30 November 2022 corresponds to the 2022/23 tax year;
- 1 December 2022 to 31 July 2023 is an eight-month period in the 2022/23 tax year; and
- 1 August 2023 to 31 July 2024 corresponds to the 2023/24 tax year.

The legislation requires the customer to add the income derived during the transitional period to other income derived in the same tax year. Therefore, the customer must add the income derived in the eight-month period from 1 December 2022 to 31 July 2023 to the income derived in the period from 1 December 2021 to 30 November 2022, giving a return for a 20-month period for the 2022/23 tax year.

Basic tax rate when changing balance dates

55. When a change of balance date occurs, a customer's basic tax rate is calculated in accordance with ss 39(5) to (7). For more information about basic tax rates when a change of balance date occurs see New legislation: Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 Tax Information Bulletin, Vol 29, No 5 (June 2017): **156-158**.

GST and provisional tax consequences

56. Section 39B sets out the treatment for customers with provisional tax and GST liabilities, which may also need to be considered when a customer elects to change a balance date.

57. Provisional tax and GST consequences of changing a balance date for income tax purposes are discussed in New legislation: Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Act 2006 Tax Information Bulletin, Vol 18, No 5 (June 2006): **73**:

 > When a taxpayer changes their balance date, until the new balance date is reached the taxpayer must continue to pay provisional tax on the instalment dates that applied before the change of balance date. Once the new balance date is reached the taxpayer pays provisional tax on the instalment dates relating to the new balance date.
 >
 > Instalments of provisional tax in this transitional year are due on the 28th of the months specified in Schedule [3], Part B and the final instalment is due on the 28th of the month following the final month in the transitional year or 15 January where November is the final month.
 >
 > The provisions relating to the calculation of provisional tax liability using the standard and estimation options are similar. However, the legislation introduces rules for the calculation of provisional tax in the transitional year for those taxpayers who use the GST ratio method. When a taxpayer changes their balance date and moves from a set of instalment dates in even-numbered months to a set of instalments in odd-numbered months or vice versa, there will be a one-month period when GST and provisional tax are due before they change to their new balance date. The taxpayer will determine the amount of provisional tax due for this period by applying the ratio to the one-month's GST taxable supplies.
 >
 > When a taxpayer (other than a GST ratio method taxpayer) changes their balance date and their GST taxable periods do not align with their new balance date, the taxpayer must change their GST taxable periods to align with the new balance date. This is achieved by truncating the last taxable period before the new balance date so that the taxable periods and income year end on the same date.

58. Sections 15B and 15D of the Goods and Services Tax Act 1985 refer to the alignment of GST return taxable periods with income tax balance dates and refer to a GST-registered person's obligation to align their GST return periods to a changed income tax balance date.
59. When a customer who is liable to pay provisional tax and is GST registered (other than a GST ratio-method taxpayer) changes their balance date so their GST taxable periods no longer align with the new balance date, their GST taxable periods need to be changed to align with the new balance date.
60. Should a realignment of GST return taxable periods be required, realignment is to take effect in the income year when a new balance date is applied.
61. Where realignment is required, the Commissioner must make an adjustment to truncate the last GST return taxable period before a new income year and balance date is applied. The customer does not need to separately apply to the Commissioner for a change to their GST taxable periods.
62. A customer who is liable to make provisional tax payments must continue to pay provisional tax on the instalment dates that apply before the change of balance date is applicable to their income tax return filing obligations. The provisional tax instalment dates change in the income year that a new balance date takes effect, which is either the transitional return period or a new business customer's first return period.
63. On agreement to change a balance date, Inland Revenue staff handling balance date change requests will alert customers to the impact of transitional return periods, GST return taxable period realignment and provisional tax payment instalment dates and related timing of these change impacts (if applicable).

Provisional tax and consolidated groups

64. Where a company changes balance dates before joining a consolidated group, there may be provisional tax consequences to consider.
65. As outlined above, a change of balance date gives a company a transitional tax return period with consequent provisional tax instalment dates. In contrast, the group will not have a transitional return period and the group will be responsible for provisional tax, not the companies in the group. The provisional tax instalment dates will therefore depend on the group's balance date.
66. This could result in instalments being due earlier in the income year than they would be for the company. Some groups will have due dates before the election to form or join a consolidated group because elections can be accepted up to 63 working days after companies first become entitled to elect (see s FM 38 of the ITA).

Consequences for financial reporting obligations

67. Section 43(1) of the FRA allows the Commissioner to approve a change of balance date for "specified entities" that have financial reporting obligations under certain other enactments.

When an entity's balance date is set by the Financial Reporting Act 2013

68. A "specified entity" is an entity where an enactment defines its balance date by reference to s 41 of the FRA (s 40(2) of the FRA). Specified entities include (this is not an exhaustive list):
    a) companies required to prepare financial statements and/or annual reports under the Companies Act 1993;
    b) partners of a partnership required to prepare financial statements under the Partnership Law Act 2019;
    c) general partners of limited partnerships required to prepare financial statements under the Limited Partnerships Act 2008; and
    d) entities required to prepare financial statements and/or climate statements under the Financial Markets Conduct Act 2013.
69. A specified entity's balance date will be the close of 31 March or any other date adopted with the Commissioner's approval (s 41(1) of the FRA). However, there are two exceptions to this general rule:
    a) If a specified entity had a balance date other than 31 March immediately before 1 April 2014, this continues to be the entity's balance date under the FRA (s 41(2) of the FRA).
    b) If a specified entity is affected by an Act that defines the balance date or the financial year of the entity, that is the entity's balance date under the FRA (s 41(3) of the FRA). For example, under the definition of financial year in s 136(1) of the Crown Entities Act 2004, the balance date of a Crown entity is 30 June or any other date determined for that entity by the Minister of Finance.
70. In both of the above circumstances, a specified entity may have a balance date for financial reporting obligations other than 31 March without the Commissioner's approval.
71. In addition, the FRA does not determine the balance date for all entities with financial reporting obligations. There will be entities with financial reporting obligations that will not be specified entities, because the reporting obligations they are subject to are set out in enactments that do not define their balance date by reference to s 41 of the FRA. For example, a charitable entity's balance date in relation to its obligation to prepare an annual return is determined in accordance with s 41(3) to (7) of the Charities Act 2005 not the FRA.

When the Commissioner will approve a change to a financial reporting balance date

72. When a customer has financial reporting obligations to a balance date set by the FRA and the Commissioner approves a change to the customer's balance date for income tax purposes, the Commissioner will generally align the customer's balance date for these obligations with the new income tax balance date, relying on s 43(1) of the FRA.
73. However, if a change to a customer's balance date has been approved for income tax purposes to align with a date that is already used for financial reporting, it is not necessary for the Commissioner to approve a change to the balance date the customer is using for financial reporting purposes.
74. The Commissioner may also approve a change of balance date, under s 43(1) of the FRA, for a customer that has financial reporting obligations who is not required to file an income tax return.

Transitional year for financial reporting obligations

75. If an entity is changing balance dates, the FRA specifies that the period between any two balance dates must not be more than 15 months (s 43(2) of the FRA). However, as illustrated in Example 7 above, a customer may be required to file a transitional income tax return for a period of more than 15 months.
76. Where a customer's balance date has been changed for financial reporting purposes under s 43 of the FRA and income tax purposes under s 38, the customer may need to prepare two sets of financial statements (or two of any other document prepared to a balance date defined by reference to the FRA) for the period covered by the transitional income tax return to ensure the 15-month limitation in the FRA is not breached. This is illustrated in Example 8.

Example 8: Transitional income tax return covering a period of more than 15 months

A customer is a partnership that changes from a balance date of 31 March to 30 September. The customer must prepare financial statements under s 60 of the Partnership Law Act 2019, so is a specified entity for the purpose of the FRA.

The customer's income tax return for the 2023/24 tax year will cover the period from 1 April 2023 to 30 September 2024 (an 18-month transitional income tax return period).

To ensure the 15-month restriction in the FRA is not breached, for the period from 1 April 2023 to 30 September 2024, the customer must prepare two sets of financial statements:

- statements covering the period from 1 April 2023 to 31 March 2024 (a 12-month period); and
- statements covering the period from 1 April 2024 to 30 September 2024 (a six-month period).

For subsequent years, the customer's income tax returns and financial statements will be prepared for the year from 1 October to 30 September.

This Standard Practice Statement is signed on 30 July 2024.

Matthew Evans

Technical Lead, Technical Standards, Legal Services

Inland Revenue

References

Legislative references

Charities Act 2005, s 41(3) to (7)

Crown Entities Act 2004, s 136(1)

Companies Act 1993

Financial Markets Conduct Act 2013

Financial Reporting Act 2013, s 40(2), 41, 43

Goods and Services Tax Act 1985, ss 15B, 15D

Income Tax Act 2007, ss EX 69, HD 16, HM 44, YA 1 ("tax year" and "corresponding income year"), YE 1(6) and (7)

Limited Partnerships Act 2008

Partnership Law Act 2019, s 60

Tax Administration Act 1994, ss 6, 33, 37, 38, 39, 39B, 138E(1)(e)(iv)

Case references

Case K41 (1988) 10 NZTC 348 (TRA)

Other references

Complaints guide – IR 1169 (guide, Inland Revenue, November 2023)
www.ird.govt.nz/-/media/project/ir/home/documents/forms-and-guides/ir1100---ir1199/ir1169/ir1169-nov-23.pdf?modified=20240115014636&modified=20240115014636

New Legislation: Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Act 2006
Tax Information Bulletin Vol 18, No 5 (June 2006): 73
taxtechnical.ird.govt.nz/tib/volume-18---2006/tib-vol18-no5

New Legislation: Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 *Tax Information Bulletin* Vol 29, No 5 (June 2017): 156-158

taxtechnical.ird.govt.nz/tib/volume-29---2017/tib-vol29-no5

SPS 18/02: Requests to change a balance date (standard practice statement, Inland Revenue, April 2018)
taxtechnical.ird.govt.nz/standard-practice-statements/general/sps-1802-requests-to-change-a-balance-date

Appendix: Industry-specific non-standard balance dates

The Commissioner recognises several industry-specific balance dates. These dates were determined following industry representations to the Commissioner. Customers in these industries, or closely aligned to them, may choose to adopt these approved industry balance dates (see [28] to [33]), subject to the Commissioner's agreement.

Industry	Recognised balance date
Beekeeping	30 November or 31 December
Services related to childcare or education	31 December
Cattle farming	31 May
Dairy farming	31 May, 30 June or 31 July
Sheep farming	30 June
Fishing	30 September
Horse breeding	31 July
Kiwifruit growing	31 January, 28 February or 31 March
Meat processing or exporting	31 August or 30 September
Orchardists, pip fruit growing	31 March, 30 June or 31 December
Seed dressing	30 November
Tobacco growing	31 July

Note: When more than one recognised industry balance date for an activity exists, the Commissioner's agreement is required for any subsequent election to adopt an alternative industry balance date.

SPS 24/02: Extension of time applications from customers without tax agents

Issued: 8 August 2024

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

This standard practice statement updates and replaces SPS 09/03 *Extension of time applications from taxpayers without tax agents.*

START DATE 05 August 2024

REPLACES

- **SPS 09/03**: Extension of time applications from taxpayers without tax agents

Introduction

This Statement sets out certain practices that the Commissioner will apply when considering applications for an extension of time to file an income tax return from customers who are not represented by a tax agent.

All legislative references in this Statement refer to the Tax Administration Act 1994 ("TAA"), unless otherwise specified.

Application

This Statement applies from *05 August 2024* and replaces SPS 09/03 *Extension of time for customers without a tax agent* published in *Tax Information Bulletin* Vol 21, No 9 (December 2009).

This Statement affects the following:

- A customer who is not represented by a tax agent; or
- A customer whose tax agent no longer qualifies as a tax agent; or
- Is a tax agent without a current extension of time.

Definitions

The following terms are used throughout this Statement:

- Tax agent: A person is eligible to be a tax agent under section 124C(3) when they prepare income tax returns for 10 or more persons, and is either one of the following:
  - (i) a person carrying on a professional public practice;
  - (ii) a person carrying on a business, occupation, or employment in which returns of income are prepared and filed; or
  - (iii) the Māori Trustee
- Due date: The date by which an annual income tax return must be filed as prescribed by section 37(1) of the TAA.
- Extension of time: an arrangement by which the Commissioner extends the due date for filing an annual income tax return to a date set by the Commissioner.

Standard practice

Summary

1. A customer without a tax agent may request for an extension of time to file their annual income tax return. The best way to make a request is via myIR or by contacting Inland Revenue by phone.
2. A tax agent does not include a nominated person or other representative that does not fall within the definition of a tax agent as defined under section 124C(3) of the TAA.

3. Customers who do not file a return by the due date may be liable for a late filing penalty. Therefore, any requests for an extension of time should be made before the due date for filing the return, or the expiry of an existing extension of time arrangement.
4. In deciding whether to grant an extension of time, the Commissioner will take into account the following:
   - The reasons for requesting an extension of time;
   - The customer's filing history; and
   - If previous extension of time arrangements had been adhered to.
5. An extension period that is appropriate to that particular customer's circumstances may be granted.
6. The customer will be notified in writing of the Commissioner's decision whether or not an extension of time is granted.
7. A customer whose tax agent no longer qualifies as a tax agent is entitled to the same extension of time that previously applied to their tax agent. Section 37(4) and (5) of the TAA allows the Commissioner to give the clients of tax agents extensions of time in which to file income tax returns up to, but not beyond, 31 March of the following year.

Detailed discussion

8. Customers who are required to file an annual income tax return must file it by the due date as prescribed by section 37(1) TAA. For customers who have a late balance date, the due date is on the 7th day of the 4th month after the end of the customer's income year. For all other customers, including those customers with an early balance date, the due date is 7 July of each year. For more information on balance dates see **SPS 24/01**: Requests to change a balance date (ird.govt.nz).
9. Under section 37(1B) an annual income tax return includes a final account that is prepopulated. This is where the Commissioner automatically issues income tax assessments.
10. A customer may apply for an extension of time to file their income tax return and the Commissioner may agree to extend the date for filing the return, where he is satisfied that the customer is unable to file the return by the prescribed due date.
11. Inland Revenue has recognised that it may be difficult for tax agents to prepare all of their clients' returns by the due date. Therefore, tax agents are generally granted an extension of time. In most cases the clients of a tax agent will automatically acquire the same extension of time status as their tax agent.
12. To ensure those customers who are not represented by a tax agent are not disadvantaged, Inland Revenue will consider applications for an extension of time on a case by case basis. The particular circumstances of the customer will be taken into consideration as far as the law permits.
13. Under section 37(3B) an extension of time can be advised by the Commissioner due to an Inland Revenue digital platform system issue that hinders or disadvantages a customer from providing the required return or income information.
14. In some circumstances a tax agent may no longer qualify as a tax agent or may lose their extension of time. In this situation a customer can apply for an individual extension of time. Section 37(4B) of the TAA allows the Commissioner to extend those customers' filing date to 31 March on or after the original extension date.
15. The due date for filing an income tax return for all customers, with or without a tax agent, cannot be extended beyond 31 March of the following year as per section 37(5) of the TAA.
16. Customers who do not file a return by the due date may be liable to a late filing penalty. Therefore, customers are encouraged to request an extension of time before the due date, or before an existing extension of time arrangement expires.

Request for an extension of time

17. Customers can make a request for an extension of time in the following ways:
    - By sending a request using myIR;
    - Phone; or
    - Post.
18. When making a request, customers should state clearly that they are requesting an extension of time.

19. To ensure that Inland Revenue is able to consider the request for an extension of time, the following information should be provided:
    - The customer's name and IRD number;
    - The type of return required to be filed (e.g. IR3);
    - The return period to which the extension applies;
    - The length of the extension of time required; and
    - The reasons for requesting an extension of time.

Timing

20. A request for an extension of time should be made on or before the due date for filing the return. However, the legislation confers a discretionary power to the Commissioner to accept applications after the due date in some cases, or class of cases.

The Commissioner's consideration

21. An extension of time may be granted if the Commissioner is satisfied that the customer will be unable to file a tax return by the due date. Each request for an extension of time will be considered on a case by case basis. Reasonable consideration will be given to the circumstances of the customer and whether an extension of time is appropriate for that customer.
22. In determining whether it is appropriate to grant an extension of time, the Commissioner will consider the following:
    a. The reasons for requesting an extension;
    b. The customer's return filing history; and
    c. If previous extension of time arrangements had been adhered to.

Reasons for requesting an extension

23. Examples of circumstances that the Commissioner may consider appropriate for granting an extension of time include:
    a. The customer is unable to obtain records eg:
       - Unable to obtain the necessary information to file the return. This includes waiting on information from Inland Revenue,
       - A significant weather event

    b. Dependent on other income eg: Waiting on the finalisation of accounts for a related customer or entity
    c. Customer is sick or injured
    d. Customer is overseas. Developments in technology mean that even when customers are overseas they will be able to file electronically. A planned holiday in unlikely to justify an extension of time. However, where a customer is overseas and there are other factors beyond their control (such as, illness in the family, Government imposed restrictions on travel, adverse events, and so on) then the Commissioner may consider it appropriate to grant an extension.
24. These are merely some examples of circumstances in which the Commissioner may grant an extension of time. There may be other situations under which an extension of time may be appropriate.

Return filing history

25. The Commissioner will also take into account the customer's return filing history in considering whether to grant an extension of time.
26. If the customer has other outstanding returns it is unlikely that an extension of time will be granted for the current year's return, unless there are legitimate reasons for not filing the outstanding returns for the previous years.
27. It should be noted that any extension of time agreed to would only apply to the current year's return and not to the other outstanding returns. The prescribed maximum period for an extension relating to the previous years' returns would have elapsed in most cases and the Commissioner cannot grant an extension beyond that prescribed date. (Refer to "Period of Extension" in paragraphs 29 to 31).

Previous extension of time arrangements

28. Where a customer has previously been granted an extension of time but has failed to adhere to that arrangement, it is unlikely that the Commissioner will agree to a further extension of time unless there are legitimate reasons for the customer's failure to adhere to the earlier arrangement.

Period of Extension

29. The maximum period for an extension of time that can be granted to any customer is 31 March of the following year as per section 37(5) of the TAA. This applies to customers with a standard balance date and a non-standard balance date. For example, the final extension date that the Commissioner may grant to file a return relating to the 2023/24 income year is 31 March 2025.
30. The Commissioner will not necessarily agree to the maximum extension period in every case. The period of extension will be set after giving reasonable consideration to the reasons for the delay and the circumstances of the customer.
31. Where an extension of time has been granted and the customer is subsequently unable to meet the new due date, then before the expiry of the extension of time they should request a further extension to avoid a late filing penalty. Again, there must be legitimate reasons for a further extension of time to be granted.

Customers whose tax agent no longer qualifies as a tax agent

32. In most cases customers who are represented by a tax agent will automatically acquire the same extension of time given to their tax agent. However, if that tax agent ceases to be a tax agent before the extension of time expires, the Commissioner is required to extend the filing date for those customers to 31 March on or after the original extension date.
33. For example, a tax agent has an extension of time to file their client's tax returns by 31 March 2024. The tax agent is removed as a tax agent on 30 November 2023 and their clients are now required to file their own returns. Those customers will be granted an extension of time to file their tax returns by 31 March 2024.

Notification and confirmation - extension of time granted or declined

34. Customers requesting an extension of time over the telephone will usually be notified immediately whether an extension is granted or declined.
35. Requests made via myIR will receive a response via myIR.
36. In all cases, once a decision has been made, Inland Revenue will write to the customer confirming the granting or declining of an extension of time.

Late filing penalties

37. A late filing penalty may be imposed if a return is not filed by the due date, or by the date agreed to in an extension of time arrangement.
38. Should the customer fail to file the return by the due date, or the agreed date, the Commissioner will first give the customer a 30 day notice of an intention to impose a late filing penalty.
39. The late filing penalty will generally not be reversed if it has been imposed before an extension of time was granted.
40. However, the late filing penalty may be remitted in certain circumstances. The criteria for remitting late filing penalties are contained in sections 183A and 183D.
41. Remission applications under sections 183A and 183D will only be considered when the return relevant to the remission request has been filed and any tax due has been paid.
42. For more information on late filing penalties and remission of penalties, see SPS 19/04 - Late filing penalties (ird.govt.nz) Late Filing Penalty and SPS 18/04 – Options for relief from tax debt (ird.govt.nz) (or any subsequent replacements of these SPS's).

This Standard Practice Statement is signed on 5 August 2024.

Matthew Evans
Technical Lead, Technical Standards

Legislative references

The relevant legislative provisions are sections 37, 183A, and 183D

Section 37 – Dates by which annual returns to be furnished

(1) The annual returns of income required under this Act shall be furnished to the Commissioner as follows:

(a) [Repealed]

(b) in the case of any taxpayer with a late balance date, not later than the seventh of the month which is the fourth month after the end of the taxpayer's corresponding income year:

(c) in all other cases, not later than 7 July in each year.

(1B) For the purposes of this section, an annual return of income for an individual to whom Part 3, subpart 3B applies, means a final account described in section 22D(6) containing the income information of the individual for the tax year.

(2) The Commissioner shall give public notice of the days by which the returns are required to be furnished by publishing the notice in such manner as the Commissioner thinks fit; but the omission to give any such notice shall not affect the liability of any person to furnish any return within the time prescribed by this section in that behalf.

(3) Subject to subsection (5), where any taxpayer satisfies the Commissioner that the taxpayer is unable to furnish the required return by the due date required under this section, the Commissioner, upon application by or on behalf of the taxpayer on or before that date, or within such further period as the Commissioner may allow in any case or class of cases, may extend the time for furnishing the required return to such date as the Commissioner thinks proper in the circumstances.

(3B) Subject to subsection (5), an extension of time to a date advised by the Commissioner is available to a person or a class of persons if—

(a) a systems issue arises for an Inland Revenue digital platform resulting in a person or class of persons being prevented from, or being otherwise hindered or disadvantaged in, providing the required return or income information; and

(b) a proportionate extension of time is considered proper in the circumstances.

(4) Subject to subsection (5), the Commissioner may extend a tax agent's time for furnishing a return of income for any taxpayer to a date the Commissioner thinks proper in the circumstances, if the Commissioner is satisfied that—

(a) the tax agent is unable to furnish the return of income on or before the date set by subsection (1); or

(b) it would be unreasonable, having regard to the circumstances of the tax agent preparing the return, to require the return to be furnished on or before the date set by subsection (1).

(4A) If a tax agent has not furnished for a tax year the required number of tax returns by the dates specified by the Commissioner, the Commissioner may:

(a) refuse to grant an extension of time under subsection (4) for furnishing 1 or more tax returns that are linked to the tax agent; and

(b) cancel any existing extension of time arrangement granted under subsection (4) for the tax years for which the tax agent has not furnished the required number of tax returns by the dates specified by the Commissioner; and

(c) cancel any existing extension of time arrangement granted under subsection (4) for 1 or more returns, but not necessarily all returns, for the tax years for which the tax agent has not furnished the required number of tax returns by the dates specified by the Commissioner.

(4B) If the Commissioner extends under subsection (4) the time for a person listed as a tax agent to furnish a return of income for a taxpayer and the person ceases to be a tax agent before the extension of time would have expired, the Commissioner must extend the taxpayer's time for furnishing the return to a date of 31 March on or after the date that would have applied if the person had continued to be a tax agent.

(5) For the purposes of subsections (3) and (4),—

(a) where the return required to be furnished by any taxpayer is a return for a year ending on 31 March, the time for furnishing that return shall not be extended or further extended to a time later than the 31 March that immediately succeeds that 31 March:

(b) where the return required to be furnished by any taxpayer is, by consent of the Commissioner under section 38, a return for a year ending with the date of the annual balance of the accounts of the taxpayer, the time for furnishing that return shall,—

(i) where that date is between 30 September and the next succeeding 31 March, not be extended or further extended to a time later than the 31 March next succeeding the 31 March that immediately succeeds that date:

(ii) where that date is between 31 March and the next succeeding 1 October, not be extended or further extended to a time later than the 31 March that immediately succeeds that date.

183A - Remission for reasonable cause

(1) This section applies to—

(a) a late filing penalty:

(b) a non-electronic filing penalty:

(c) a late payment penalty:

(d) imputation penalty tax imposed by section 140B:

(e) [Repealed]

(f) Maori authority distribution penalty tax imposed by section 140CB:

(g) a shortfall penalty imposed by section 141AA:

(h) a civil penalty imposed under section 215 of the KiwiSaver Act 2006:

(i) an employers' withholding payment penalty imposed by section 141ED.

(1A) The Commissioner may remit the penalty if the Commissioner is satisfied that—

(a) a penalty to which this section applies arises as a result of an event or circumstance beyond the control of a taxpayer; and

(b) as a consequence of that event or circumstance the taxpayer has a reasonable justification or excuse for not furnishing the tax return or their employment income information, or not furnishing their employment income information in a prescribed electronic format, or not paying the tax on time; and

(c) the taxpayer corrected the failure to comply as soon as practicable.

(2) Without limiting the Commissioner's discretion under subsection (1), an event or circumstance may include—

(a) an accident or a disaster; or

(b) illness or emotional or mental distress.

(3) An event or circumstance does not include—

(a) an act or omission of an agent of a taxpayer, unless the Commissioner is satisfied that the act or omission was caused by an event or circumstance beyond the control of the agent—

(i) that could not have been anticipated; and

(ii) the effect of which could not have been avoided by compliance with accepted standards of business organisation and professional conduct; or

(b) a taxpayer's financial position.

183D - Remission consistent with collection of highest net revenue over time

(1) The Commissioner may remit—

(a) a late filing penalty; and

(aa) a non-electronic filing penalty; and

(b) a late payment penalty; and

(bb) a shortfall penalty imposed by section 141AA; and

(bc) a civil penalty imposed under section 215 of the KiwiSaver Act 2006; and

(bd) an employers' withholding payment penalty imposed by section 141ED; and

(c) interest under Part 7—

payable by a taxpayer if the Commissioner is satisfied that the remission is consistent with the Commissioner's duty to collect over time the highest net revenue that is practicable within the law.

(2) In the application of this section, the Commissioner must have regard to the importance of the penalty, and interest under Part 7, in promoting compliance, especially voluntary compliance, by all taxpayers and other persons with the Inland Revenue Acts.

(3) The Commissioner must not consider a taxpayer's financial position when applying this section.

TECHNICAL DECISION SUMMARIES

Technical decision summaries (TDS) are summaries of technical decisions made by the Tax Counsel Office. As this is a summary of the original technical decision, it may not contain all the facts or assumptions relevant to that decision. A TDS is made available for information only and is not advice, guidance or a "Commissioner's official opinion" (as defined in s 3(1) of the Tax Administration Act 1994). **You cannot rely on this document as setting out the Commissioner's position more generally or in relation to your own circumstances or tax affairs**. It is not binding and provides you with no protection (including from underpaid tax, penalty or interest).

TDS 24/15: GST – payment for participation in religious practice

Decision date | Rā o te Whakatau: 8 April 2024

Issue date | Rā Tuku: 30 July 2024

Subject | Kaupapa

GST: participation in religious practices; whether for consideration and a taxable supply

Taxation laws | Ture tāke

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

Facts | Meka

1. The Taxpayer is registered for GST and carries on a taxable activity and makes taxable supplies.
2. The Taxpayer is a registered charity under the Charities Act 2005. It also falls within the definition of "non-profit body" in s 2.
3. The Taxpayer's members participate in certain religious practices. For participation in some of the practices, payments were required to be made by the members to the Taxpayer. The dispute was about the religious practices for which payment was generally required.
4. The Taxpayer had filed returns in which it returned GST on the amounts received for the participation in the religious practices
5. The Taxpayer subsequently proposed adjustments to reverse the inclusion of GST on the amounts. Customer and Compliance Services, Inland Revenue (CCS) rejected the proposed adjustments as it considered the GST positions as filed were correct.
6. The parties didn't come to agreement and the dispute was referred to the Tax Counsel Office, Inland Revenue (TCO) for adjudication.

Issue | Take

7. The main issue considered in this dispute was:
   - Whether the Taxpayer was liable for GST in relation to the payments received for participation in religious practices, being consideration for the supply of goods and services by a registered person in the course or furtherance of a taxable activity.

Decisions | Whakatau

8. The Tax Counsel Office (TCO) concluded:
   - The Taxpayer was liable for GST in relation to the payments.

Reasons for decisions | Pūnga o ngā whakatau

Issue | Take: Whether the payments were subject to GST

9. In deciding whether the payments were subject to GST, TCO considered the charging of GST under s 8 and whether the payments were consideration for the supply of services.
10. Whether the payments were consideration depended on:
    - Whether there was reciprocity (a sufficient connection) between the payments and supplies of services.
    - Whether the payments were "unconditional gifts", which involved considering:
        - whether the payments were voluntary; and
        - whether "identifiable direct valuable benefits" arose, or may have arisen, for the members in respect of the payments.
11. TCO also considered arguments about consistency of treatment between taxpayers.

The charging of GST under s 8

12. Under s 8, GST is charged on the supply (but not an exempt supply) in New Zealand of goods and services by a registered person in the course or furtherance of a taxable activity carried on by that person. The GST is charged by reference to the value of the supply.

Supply of services

13. The definition of "services" in s 2 is very wide. It includes "anything" that is not "goods or money or cryptocurrency." The religious practices involved the Taxpayer's staff or volunteers guiding members through the course content. This fell within the meaning of "services". The definition of "services" does not contain any exception for services of a religious nature.

In the course or furtherance of a taxable activity

14. The supply of the religious practices was carried out in the course or furtherance of a taxable activity, as required by s 8.
15. The word "activity" is of considerable breadth. It means a course of conduct or series of acts that a person has chosen to undertake or become engaged in. The supply of the services fell within this definition of "activity". This was an activity of the Taxpayer because it involved the use of the Taxpayer's resources, staff and volunteers and was conducted in accordance with the Taxpayer's policy. This was in addition to the activity of supplying books and premises, which the Taxpayer accepted it carried on.
16. A business or commercial overlay is not a requirement for an activity to be a taxable activity.
17. For an activity to be a taxable activity, the activity must be carried on continuously or regularly. There was no dispute that the activity involving the participation in the religious practices was carried on regularly by the Taxpayer.
18. For an activity to be a taxable activity, the activity must involve, or be intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration. It is sufficient if the activity in fact involves the supply of goods and services regardless of whether there is a subjective intention to make supplies. Further, for the reasons discussed below, TCO concluded that the supply of the religious practices was made for consideration.
19. Finally, the definition of taxable activity does not contain any exemption for religious activities.
20. GST is not charged on "exempt supplies". "Exempt supplies" is defined in s 14. The supply of participation in the religious practices did not come within this definition. Unlike in the law of other countries, the GST Act does not contain any exemption for supplies that have a religious nature.

Value of the supply

21. GST is charged on a supply by reference to the value of the supply. Section 10 applies for the purpose of determining the value of any supply of goods or services.
22. In the absence of an associated party supply, s 10 calculates the value of a supply based on the consideration paid for it. There is no requirement or ability to value the supply in any other way. In the absence of an associated party supply, the GST Act does not question whether the objective value of the supply matches the consideration provided.

23. Under s 10(18) where a taxable supply is not the only matter to which a consideration relates, the supply is deemed to be for such part of the consideration as is properly attributable to it. This subsection applies only if it can be shown that part of the payment relates to another matter. This must be demonstrated by reference to the true legal character of the transaction, not merely the substance of the transaction. It also cannot be inferred from the market value of the goods or services provided. This is because s 10(2) does not enquire into the adequacy of consideration.
24. In the present dispute, the Taxpayer had not demonstrated that any part of the payments in question were unconditional gifts. The evidence suggested that the payments were, in full, for the services supplied.

Consideration

25. Relevant to the dispute, "consideration" includes any payment made, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any services, but does not include an unconditional gift to any non-profit body.

Reciprocity between the payment and the supply

26. For a payment to be consideration for a supply there must be reciprocity between the payment and the supply. In the dispute, it was considered that reciprocity existed because the supply of participation in the specific religious practices in dispute was generally conditional on payment being made.
27. The Taxpayer did not provide any details or evidence of any instances where participation in the specific religious practices, for which a set payment amount had been established, were provided for free. Even if there were some occasions where payments had been waived, this did not alter the general character of the transaction.
28. The Taxpayer's arguments to the contrary were not accepted. In particular:
    - The fact that the payments become the property of the Taxpayer and how the Taxpayer used the funds were irrelevant in determining the character of the payments.
    - The relevant question was not whether the acquisition of the services in dispute was mandatory, but rather whether payment was required if a member wished to acquire the services.
    - The inability (generally) to obtain a refund was not determinative of whether the payments were consideration for supplies.
    - The fact that the payments received were not allocated to meet the costs of participation in the religious practices was irrelevant.
    - The fact that the costs of supplying participation in the religious practices, when compared to the payments made by the members to the Taxpayer, may have been equal to only a small proportion of the payments, did not mean that part of the payments were made for something other than the religious practices. The fact that the payments funded the Taxpayer's other activities and that the members may have been aware of this, was also not determinative.
    - That the members may have been motivated to fund the Taxpayer's other activities does not change the legal nature of the transaction. The members were helping to fund the Taxpayer's activities by acquiring services from the Taxpayer.

Unconditional gift

29. A payment is not consideration if the payment is an "unconditional gift" to a non-profit body. To be an unconditional gift a payment must be made voluntarily.

    Made voluntarily

30. The payments were not made voluntarily. The meaning of "voluntary" must be interpreted in the context of the definitions of unconditional gift and consideration. In this context, a payment is not made voluntarily if the payment is made for a supply of a service and the supply is conditional on the payment being made. In this case, the supply of participation in the religious practices was generally conditional on the payments being made.
31. This was, on its own, sufficient reason to conclude that the payments in dispute were not unconditional gifts.

    No identifiable direct valuable benefit

32. To be an unconditional gift, in respect of the payment, there must be no "identifiable direct valuable benefit" that arises or that may arise in the form of a supply of goods and services.
33. TCO concluded that, in respect of the payments, an "identifiable direct valuable benefit" arose, or may have arisen, in the form of the supply of participation in the religious practices. This was a further reason to conclude that the payments were not unconditional gifts.

34. Even if it had been necessary to look beyond the receipt of the service for the benefit, it was considered that the benefit requirement would be satisfied by the spiritual or moral development and advancement that arose, or that may have arisen, from the religious practices in which the members participated.
35. The spiritual or moral benefit received by members from the services was a personal benefit and an end in itself for the members. The receipt of the benefit was not incidental or to facilitate the advancement of religion generally. Therefore, this was not a benefit that would be disregarded by a court.
36. The benefit received was identifiable. The benefit was the supply of participation in the religious practices or the spiritual and moral development that arose, or that may have arisen, from the services.
37. The benefit was direct. The benefit received by the members from the services was received by each of the members alone, rather than by a class of people. Also, the benefits in the form of the supply of participation in the religious practices (that is, the particular practices in dispute), would not have been obtained irrespective of whether the payments were made.
38. The benefit was also valuable. A benefit is valuable in this context if it is not nominal. The benefit, in the form of the supply of participation in the religious practices, was not nominal, as it involved considerable time and resources to provide.
39. The benefit was also capable of valuation. The Taxpayer had, in fact, placed a value on these services. The payments requested varied depending on the specific religious practices in which members participated. The members also appeared to place a financial value on the religious practices by agreeing to make the payments. Although, the members may also have been motivated by a desire to fund the practices of the Taxpayer, the Taxpayer had not shown that the members did not also value the services they received in return for the payments. Further, if necessary, a valuation could be calculated based on the cost of providing the services plus a mark-up.

Consistency

40. The Taxpayer argued that charging GST on the payments in dispute was inconsistent with the tax treatment of payments made to other religious organisations.
41. The Commissioner has a duty to ensure the correctness of an assessment. In doing so, it is irrelevant if the correct tax treatment determined is inconsistent with assessments or views the Commissioner may have previously made or expressed, either generally or in relation to a particular taxpayer.
42. In this dispute, the Commissioner was solely concerned with the correctness of the Taxpayer's assessments. Whether the assessments were consistent with the assessments of other taxpayers (some of which may be self-assessed) was irrelevant.

Conclusion

43. The Taxpayer was liable for GST in relation to the payments received, being consideration for the supply of services.

TDS 24/16: Look-through company election

Decision date | Rā o te Whakatau: 27 March 2024

Issue date | Rā Tuku: 8 August 2024

Subjects | Kaupapa

Look-through company; look-through counted owner; available capital distribution amount; tainted capital gains

Taxation laws | Ture tāke

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

Summary of facts | Whakarāpopoto o Meka

1. The Arrangement in this ruling involves the Applicant, a company, electing to be a look-through company (the Election) and the liquidation of a wholly owned subsidiary (Subsidiary A).
2. The Applicant has three shareholder trusts – Trusts A, B and C. Each trust was settled by a sibling of a family (the Settlor). Each trust benefits the respective Settlor of the trust and a combination of their respective spouses, children, the children's spouses, their children and/or grandchildren, or family trusts that benefit these family members.
3. Trust A has a corporate trustee (the Corporate Trustee). The Corporate Trustee is wholly owned by the Settler of Trust A and has four directors (including the Settlor of Trust A). In the three income years prior to the Election, Trust A has made income distributions to a company that was wholly owned by the Corporate Trustee (the Beneficiary Company) and to a registered charity (the Charity). The Settlor of Trust A is also the settlor and a trustee of the Charity. The Charity has no ability to influence or control Trust A or the management of the Applicant. It is contemplated that the Charity will continue to receive distributions from Trust A.
4. At the time the Applicant was incorporated, the shares in a company (Subsidiary B) were transferred from the then shareholder to the Applicant. At the same time, Subsidiary B transferred its shareholding in Subsidiary A to the Applicant, giving rise to a capital gain for Subsidiary B. The Applicant and the Commissioner, at the time, agreed that this share-for-share exchange was subject to the available subscribed capital (ASC) limitation in s CD 43(9)-(14). As a result, the ASC in the Applicant was no more than the ASC that existed in Subsidiary B.
5. Further, for tax purposes, the Applicant and the Commissioner agreed on the cost of acquiring the shares in Subsidiary B incurred by the Applicant (the Agreed Amount).

Issues | Take

6. The main issues considered in this ruling were:
    - Whether the Applicant met the requirement of having five or fewer "look-through counted owners".
    - Whether the income distributions made to the Beneficiary Company and the Charity prior to the Election, and any future distributions made to the Charity, would prevent the Applicant from satisfying the definition of "look-through company".
    - Whether the "cost" of the shares in Subsidiary B for the purposes of s CD 44 (and, therefore, when calculating the amount of the dividend under ss CD 26 and CB 32C) is the Agreed Amount.
    - Following the liquidation of Subsidiary A, whether the gain derived by Subsidiary B on its disposal of the shares in Subsidiary A to the Applicant would be within s CD 44(10B).
    - Whether s BG 1 applied to negate or vary the outcome to the above issues.

Decisions | Whakatau

7. The Tax Counsel Office (TCO) decided that:
   - The Applicant has three "look-through counted owners" and therefore met the requirement of having five or fewer "look-through counted owners".
   - The income distributions made to the Beneficiary Company and the Charity prior to the Election, and any future distributions made to the Charity, would not prevent the Applicant from satisfying the definition of "look-through company".
   - The "cost" of the shares in Subsidiary B for the purposes of s CD 44 (and, therefore, when calculating the amount of the dividend under ss CD 26 and CB 32C) is the Agreed Amount.
   - Following the liquidation of Subsidiary A, s CD 44(10B) would no longer apply to the gain derived by Subsidiary B on its disposal of the shares in Subsidiary A to the Applicant.
   - Section BG 1 did not apply to negate or vary the outcome to the above issues.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Look-through counted owners

8. For the Applicant to elect to become a look-through company (LTC), it can have only five or fewer "look-through counted owners".
9. Relevantly, under the "look-through counted owner" (LTCO) definition in s YA 1, the following are LTCOs:
   - A natural person who has derived beneficiary income arising from a direct or indirect beneficial interest in shares in an LTC, in the current income year or one of the last three income years (para (b)).
   - A natural person who receives a trust distribution in the current income year or one of the last three income years and the trust has a direct or indirect beneficial interest shares for the LTC (para (bb)).
   - A trustee of a trust (treating co-trustees as one person) with a direct or indirect beneficial interest in the shares in an LTC where no beneficiary of the trust is a LTCO (para (c)).
   - A natural person that has a voting interest or a market value interest for the LTC that has derived beneficiary income arising from a direct or indirect beneficial interest in shares for the entity for the current income year or one of the last three income years ((para d)).
10. Also relevant is paragraph (d) of the definition of "look-through company" which treats LTCOs who are relatives as one LTCO.
11. A "relative", as defined in s YA 1, includes a person within the second degree of blood relationship to a person; a spouse; and a spouse of a person who is within the second degree of blood relationship to a person.
12. To determine how many LTCOs the Applicant has, it was necessary to look through to the ultimate owners of the Applicant.

Trust A

13. In the three income years prior to the Election, Trust A made income distributions to:
    - The Settlor of Trust A and their children.
    - A family trust of which the Settlor and their children are beneficiaries.
    - The Beneficiary Company.
    - The Charity.
14. TCO concluded that the beneficiaries of Trust A, together, are considered a single LTCO for these reasons:
    - the Settlor and their children are all natural persons who derived beneficiary income from Trust A. Trust A has a direct beneficial interest in the shares of the Applicant. Therefore, paragraph (b) of the definition of LTCO applied. The Settlor and their children are treated as one LTCO because they are "relatives", being within two degrees of blood relationship to one another.

- The Settlor and their children are also beneficiaries of the family trust and therefore have an indirect beneficial interest in the shares in the Applicant. However, as the Settlor and the children are "relatives", their interests in the family trust are not treated separately to their interest as natural persons. Therefore, the Settlor, their children and the family trust are treated as one LTCO.
- The Beneficiary Company is not an LTCO. Paragraph (c) of the definition of LTCO applies where a trustee of a trust holds a beneficial interest in an LTC but has no beneficiaries that are LTCOs. In this case, the other beneficiaries of Trust A are LTCOs, so paragraph (c) cannot apply. None of the other paragraphs in the definition of LTCO applies.
- The Charity is also not an LTCO. The Charity is not a named beneficiary of Trust A, nor does it own shares in the Applicant (either directly or indirectly). It has no control over Trust A or the Applicant. Therefore, paragraph (c) of the definition of LTCO does not apply. None of the other paragraphs in the definition of a LTCO applies.

Trust B

15. In the three income years prior to the Election, Trust B made income distributions to:
    - a family trust which made distributions to the Settlor of Trust B, their spouse, and the children's trust, and
    - through the children's trust, to the children, their children's spouses and their grandchildren.
16. Both the family trust and the children's trust have an indirect beneficial interest in the Applicant under paragraph (bb) of the LTCO definition. However, as the beneficiaries are "relatives", the Settlor of Trust B, their spouse and their children are treated as one LTCO.

Trust C

17. In the three income years prior to the Election, Trust C made income distributions to the Settlor of Trust C and their children.
18. As Trust C has a direct beneficial interest in the Applicant, but the Settlor and their children are "relatives", they are treated as one LTCO under paragraph (bb).

Overall number of LTCOs

19. Overall, the Applicant has three LTCOs, being the three shareholder trusts. The Charity is not an LTCO.

Issue 2 | Take tuarua: Distributions made to the Beneficiary Company and the Charity

20. Under the LTC provisions, an entity must meet all the requirements of the definition of LTC at all times in the income year in order to be eligible to be an LTC.
21. TCO considered whether the income distributions made to the Beneficiary Company and the Charity by Trust A prior to the Election would prevent the Applicant from meeting paragraph (eb) of the LTC definition in s YA 1. TCO also considered whether any future income distributions made to the Charity while the Applicant is an LTC would prevent the Applicant from meeting paragraph (ed) of the definition.

Distributions made to the Beneficiary Company – paragraph (eb)

22. Under paragraph (eb) of the LTC definition, if an entity is owned by a trustee of a trust, that entity cannot be an LTC if the trust makes a distribution to a company. The exceptions in paragraph (eb) do not apply here.
23. Therefore, any distributions made by Trust A to the Beneficiary Company once the Applicant is an LTC could cause it to lose LTC eligibility.
24. However, the LTC definition sets out the requirements an LTC must meet *in the income year* that the entity is an LTC. It does not refer to distributions being made in previous years. Therefore, the distributions made to the Beneficiary Company *before* the Applicant's Election would not prevent it from qualifying as an LTC. This is further confirmed by ss HB 1 and HB 13 which provide further details on what an LTC must to do for the income year it wishes to become and continue to be an LTC.

Distributions to the Charity – paragraph (ed)

25. Under paragraph (ed) of the LTC definition, if an entity is owned by a trustee of a trust, that entity cannot be an LTC if the trust makes a distribution of income to a tax charity that is a beneficiary of the trust, unless the tax charity has no control or influence in relation to the operation of the entity or to the distributions of the trust.
26. Like paragraph (eb), paragraph (ed) only applies in the income years that the Applicant is a LTC, therefore, any past distributions made by Trust A to the Charity would not prevent the Applicant from qualifying as an LTC.

27. The Charity is a registered charity and a discretionary beneficiary of Trust A. Therefore, any intended future distributions to the Charity once the Applicant is an LTC could cause it to lose LTC eligibility, unless the Charity has no control or influence over the operation of the Applicant or to the distributions of Trust A.
28. In that regard, TCO considered that there is nothing in the trust deed of either Trust A or the Charity to indicate that the two trusts are linked, apart from the Settlor of Trust A being the settlor of both trusts. When the Settlor of Trust A is carrying out their trustee duties in relation to each trust, they are required to act in the best interest of that trust. TCO did not consider that a shared trustee was sufficient to conclude that the Charity had any control or influence over the Applicant or Trust A.
29. In addition, the Charity does not have any voting interests in the Applicant, and so is unable to control or influence the operation of the Applicant, nor was there evidence to suggest that the Charity has any control or influence over the actions of Trust A, particularly in relation to distributions.
30. Therefore, TCO concluded that any future distributions made to the Charity by Trust A would not cause the Applicant to lose its eligibility to be an LTC under paragraph (ed).

Issue 3 | Take tuatoru: Cost of shares in Subsidiary B

31. Section CB 32C applies when a company becomes an LTC. It gives rise to an amount of dividend income for any person with an effective look-through interest in the company.
32. TCO was asked to confirm that when calculating the amount of dividend, the cost of the shares in Subsidiary B held by the Applicant is the Agreed Amount.
33. In calculating the amount of income under s CB 32C, the Applicant must determine the amount that would be a dividend as if the Applicant had:
    - disposed of all its property to an unrelated person at market value; and
    - met all its liabilities at market value; and
    - was then liquidated and distributed the remaining cash to its shareholders.
34. Section CD 26 provides that when a company is liquidated, a dividend arises for the shareholders to the extent that the amount paid to them exceeds the sum of the available subscribed capital (ASC) and available capital distribution amount (ACDA).
35. Section CD 44 is relevant in this case to determine the ACDA amount using the formula in s CD 44(1). The relevant item in the formula considered in this ruling is the amount of capital gains that are available for distribution (as defined in s CD 44(2)(c)).
36. Under s CD 44(7)(a), a capital gain arises to the extent that the market value of the capital asset is more than the "cost" of the asset to the company. If the market value of the shares in Subsidiary B is more than the cost of the shares to the Applicant, that difference is the capital gain and that amount would be excluded from being a dividend under ss CD 26 and CB 32C(6).
37. From case law, TCO determined that "cost" is what must be given in order to acquire something. It is generally viewed as an objectively determinable historical fact — the answer to the question of how much was paid.[1]
38. In the current case, the Applicant and Commissioner had previously agreed on the cost the Applicant incurred to acquire the shares in Subsidiary B.
39. Therefore, TCO confirmed that the cost of the shares in Subsidiary B was the Agreed Amount for the purposes of s CD 44 (and therefore, when calculating the amount of the dividend under ss CD 26 and CB 32C).

Issue 4 | Take tuawhā: Section CD 44(10B)

40. When the Applicant was incorporated, Subsidiary B derived a capital gain when it transferred the shares it held in Subsidiary A to the Applicant. In accordance with s CD 44(10B), that capital gain would not be included in the ACDA of Subsidiary B because the gain arose from a disposal of property to a company in the same wholly owned group.
41. TCO was asked to confirm that s CD 44(10B) would no longer apply in relation to the capital gain once Subsidiary A has been liquidated.

1 *Tasman Forestry Ltd v CIR* (1999) 19 NZTC 15,147 (CA); *Wilke v CIR* (1998) 18 NZTC 13,923.

42. Section CD 44(10B) provides that no capital gain is derived when property is sold between companies that have at least 85% common ownership, both at the time the property is sold and at the time of the liquidation distribution. The property in question is the shares in Subsidiary A.
43. Once Subsidiary A is liquidated, it will be removed from the Companies Register — Subsidiary A and the shares in Subsidiary A will cease to exist. This means that the relevant property for the purposes of s CD 44(10B) will cease to exist.
44. Consequently, there will be no commonality of ownership as there is no company that owns part of the property for the purposes of s CD 44(10B)(b), and therefore no "owning company". Further, the "ownership interest" will be zero, as nobody owns the property.
45. Therefore, TCO concluded that s CD 44(10B) would no longer apply to prevent the gain arising from the disposal of shares in Subsidiary A from being a capital gain amount when determining the ACDA of Subsidiary B.

Issue 5 | Take tuarima: Section BG 1 – tax avoidance

46. 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.
47. 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.
48. 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.
49. 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 and its tax effects

50. The Arrangement for s BG 1 purposes is the election of the Applicant to be an LTC, together with the liquidation of Subsidiary A. The election is made in accordance with s HB 13.
51. According to the agent of the Applicant, the commercial or private purposes of the Arrangement are to enable the shareholders of the Applicant to have better access to dividends and capital gains which might arise should any of its long-term investments be realised. The Applicant had recently undertaken a review of its structure with this purpose in mind. Various options were considered and electing into the LTC regime was the chosen option.

52. TCO considered that the Arrangement gave rise to the following tax effects:
    - Once the Applicant is an LTC, it will be transparent for tax purposes, with all of its income, expenses, gains and losses allocated to its shareholders (s HB 2). In terms of the Applicant's eligibility to become an LTC:
        - The Applicant has three LTCOs.
        - The Charity is not an LTCO.
        - Past distributions made to the Beneficiary Company and the Charity, and any future distributions made to the Charity, would not prevent the Applicant from being an LTC.
    - On election into the LTC regime, a dividend arises for the shareholders of the Applicant, calculated in accordance with s CB 32C. For the purposes of s CD 44 (and, therefore, when calculating the amount of the dividend under ss CD 26 and CB 32C), the "cost" of the shares in Subsidiary B is the Agreed Amount.
    - Following the liquidation of Subsidiary A, the gain derived by Subsidiary B on its disposal of the shares in Subsidiary A to the Applicant will not be within the scope of s CD 44(10B). This capital gain was previously "tainted" as the shares in Subsidiary A had been sold to a related party. (As Subsidiary B is not being liquidated as part of this Arrangement, this tax effect is only relevant to the calculation of Subsidiary B's ACDA in the future.)
53. By electing to be an LTC, the overall tax effect is that the Applicant would be treated as if it had been liquidated and then it would be able to distribute capital gains to its shareholders tax-free.

Tax avoidance purpose or effect – parliamentary contemplation

54. The Applicant's decision to elect into the LTC regime was to allow the shareholders to retain administrative and financial reporting simplicity, while also allowing tax-free capital gains (eg, from the sale of assets) to be paid out to the family without requiring the liquidation of the Applicant.
55. TCO considered that the tax effects of the Arrangement were all contemplated by Parliament. This is because:
    - The shareholders of the Applicant are three trusts that hold the interests of three siblings and their families. It is clear the three family groups have effective control of the Applicant and are therefore within the intended scope of the LTC regime.
    - In terms of the Applicant's eligibility to elect to be a LTC, Parliament would not have intended that distributions made to the Charity, being an unnamed discretionary beneficiary of one of the owning trusts, would impact on the Applicant's eligibility. It is clear from the terms of the legislation that Parliament intended that an LTC could make distributions to a charity, as long as the charity could not control the LTC.
    - There is no artificiality in the fact that the Applicant qualified to elect to be an LTC, given its nature as a family-owned business.
    - The LTC regime provides special rules for the taxation of closely held companies. The treatment of LTCs as transparent is clearly provided for by the legislation and was intended by Parliament. Once a valid election is made to be an LTC, the tax consequences that arise from that election are also clearly contemplated by Parliament.
    - Once an entity becomes an LTC, capital gains are able to be distributed to shareholders tax-free, with s CB 32C providing for a dividend to arise on entry into the LTC regime that effectively triggers a tax liability on any unimputed retained earnings of the company. In calculating the amount of dividend, the LTC is required to be treated as though it had sold all its assets to a third-party and had been liquidated. This requires the cost of the relevant asset to be taken into account. In this Arrangement, Parliament would have intended that the 'cost' of the shares in Subsidiary B to be the amount that was agreed earlier between the Applicant and the Commissioner, and Parliament would expect that the Commissioner respects that agreement.
    - Section CD 44(10B) highlights that Parliament was concerned that the sale of assets between companies with significant commonality of ownership could recharacterize revenue gains as capital gains for the purpose of the ACDA calculation. Based on the requirements of the provision, Parliament intended that in situations where an asset ceases to exist (whether due to a sale to a third-party or otherwise), s CD 44(10B) would no longer apply, and the capital gain would become available.
56. TCO concluded that Parliament would consider that the Arrangement made use of the relevant provisions in a manner that is consistent with Parliament's purpose for those provisions. Therefore, the Arrangement does not have a tax avoidance purpose or effect.

57. As TCO have concluded that there is no tax avoidance purpose or effect of this Arrangement, it was not necessary for TCO to consider whether the Arrangement was a "tax avoidance arrangement" or to consider the merely incidental test.
58. It was concluded that s BG 1 did not apply to negate or vary the conclusions in this ruling.

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

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.